Annual Report 1979

FOOD FAIR, INC. Fiscal Year ended July 28, 1979

CORPORATE OFFICERS

GRANT C. GENTRY
Chairman, President
Chief Executive Officer

ROGER L. GALASSINI
Executive Vice President
General Counsel
Chief Administrative Officer

FRANK N. JAMES
Executive Vice President
Chief Operating Officer

DARRELL V. STIFFLER, JR.
Senior Vice President
Director of Industrial Relations

JAMES J. WACHTER
Senior Vice President
Chief Financial Officer

JOHN T. GRIGSBY, JR.
Vice President and Treasurer

LEONARD J. PASTERNAK
Vice President
President, Footwear Services

NEIL THALL
Vice President
Director of Management Information Systems

HOWARD F. GORDON
Secretary
Assistant General Counsel

MICHAEL MANDELBLATT
Assistant Treasurer

MARGARET M. FULTON
Assistant Secretary

EDMOND O'NEILL
Assistant Secretary

LEONARD STUBINS
Assistant Secretary

DIRECTORS

JOSEPH L. CASTLE
Management and Financial Consultant

JOHN M. FOX
Business Consultant

GEORGE FRIEDLAND
Investor

ROGER L. GALASSINI
Executive Vice President, General Counsel and Chief Administrative Officer of the Company

GRANT C. GENTRY
Chairman, President and Chief Executive Officer of the Company

FRANK N. JAMES
Executive Vice President and Chief Operating Officer of the Company

JEWEL S. LAFONTANT
Senior Partner, Lafontant, Wilkins and Butler, Attorneys-At-Law

JAMES J. NEEDHAM
Business Consultant

JAMES J. WACHTER
Senior Vice President and Chief Financial Officer of the Company

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COMMITTEES

EXECUTIVE COMMITTEE
Grant C. Gentry, *Chairman*
Roger L. Galassini
Frank N. James

AUDIT COMMITTEE
James J. Needham, *Chairman*
Joseph L. Castle
John M. Fox
Jewel S. Lafontant

COMPENSATION COMMITTEE
Grant C. Gentry, *Chairman*
George Friedland
Jewel S. Lafontant
James J. Needham

EXECUTIVE OFFICES 6500 North Andrews Ave. Fort Lauderdale, Fla. 33309

AUDITORS Touche Ross & Co. 1700 Market Street Philadelphia, Pa. 19103

REGISTRAR & STOCK TRANSFER AGENT Registrar & Transfer Company
10 Commerce Drive Cranford, N.J. 07016

6500 North Andrews Ave., Fort Lauderdale, FL 33309

Grant C. Gentry
President and
Chief Executive Officer

Food Fair, Inc.

TO: FOOD FAIR SHAREHOLDERS

Again, this year, instead of the traditional annual report, we are sending to shareholders the Form 10-K Report filed with the Securities and Exchange Commission which covers in detail the Company's performance in the fiscal year ended July 28, 1979.

The Company reported a net loss of $211 million for the year, largely the result of terminating unprofitable operations and the aftermath of the Chapter XI petitions filed on October 2, 1978. Sales from continuing operations were approximately $1 billion. Sales from terminated supermarket, J. M. Fields and ancillary operations amounted to approximately $611 million.

While the loss is significant, I am pleased to advise shareholders that, based upon interim unaudited data, the Company is now profitable and that in the first half of the current fiscal year we achieved net earnings of $1.7 million including $1.2 million profit from operations. The Company achieved earnings of $37,000 in the fiscal first quarter and $1.7 million in the fiscal second quarter. The fiscal second quarter includes $677,000 income as a result of a sugar antitrust litigation settlement, and an excess of interest income of $565,000 over bankruptcy administrative costs. More specific information on our 1980 fiscal first-half results is presented in the accompanying leaflet.

A positive factor in the Company's long-range prospects is the fact that we have undertaken a $205 million, five-year capital improvements program to modernize and expand our supermarkets and other facilities. With larger, more modern stores and equipment, our opportunities to increase sales and profits will be substantially enhanced.

In fiscal 1979, your management took the many steps necessary to restructure the Company in order to stop staggering losses and put it back on a profitable track. As I advised you previously, this meant terminating supermarket operations in Pennsylvania, New Jersey, and on the west coast of Florida, and liquidating completely our 79 J. M. Fields discount department stores. Before your present management assumed direction of the Company in January 1979, our supermarket operations in New York and Connecticut had also been terminated.

These actions, along with the closing of our meat packing and processing plants and other ancillary operations, trimmed the Company's sales from $2.8 billion to $1 billion-plus. From 440 supermarkets in operation at the Chapter XI filing we have 203 today, 123 of which are in Florida with others in Georgia, Virginia, Maryland, and Delaware. More importantly, however, we began our rebuilding program on the foundation of operations which have been historically profitable. Regrettably, in the process, we have had to terminate the employment of many, many dedicated and loyal co-workers as our personnel roster was reduced to approximately 11,000 from 31,000.

The $211 million loss in 1979 and the loss of $92 million the previous year, resulted in a deficiency in net assets of $163 million at the end of fiscal '79.

In recent weeks, we have received approval by the creditors' committees of a plan of arrangement for resolving creditors' claims and filed the plan with the bankruptcy court. The debt repayment plan contemplates the Company's return to a positive net asset position by providing for a substantial forgiveness of debt and the conversion of a significant portion of debt to preferred stock. The 10-K reviews the principal elements of the plan which will require approval by the majority of creditors in all classes, both in number and amount of claims filed and eligible to vote, and also by shareholders.

Briefly, the plan, with certain minor modifications negotiated since filing of the Form 10-K, provides for up to an 80% cash payment to trade and other non-borrowed money creditors. Twenty-five percent will be paid shortly after confirmation of the plan, expected by the end of this year, an additional 5% by March 31, 1981, and another 15% near January 15, 1985. Such creditors will receive $43.8 million of liquidating preferred stock to be liquidated at the rate of $7.3 million a year over a six-year period beginning in 1985. If the 80% cash payout is not reached at that time, the Company will make additional payments over the following three years to the extent of the Company's share of excess cash flow.

Banks and other senior debtholders will also receive a 45% cash payout not later than January 15, 1985, under the same terms as trade creditors. They also will receive $40.8 million of liquidating preferred stock to be liquidated over a nine-year period beginning in 1985. In exchange for approximately $35 million of claims, they will receive some 3.5 million shares of convertible preferred stock.

Subordinated debtholders will receive a cash payment equal to 5% of their claims by January 15, 1985. In addition, they will receive shortly after confirmation of the plan approximately 2.2 million shares of the Company's common stock in exchange for approximately $3.7 million of debt. They will also receive $5.4 million of liquidating preferred stock which will be liquidated by cash payments over a nine-year period beginning in 1985. In exchange for the balance of their claims, subordinated debtholders will receive approximately 1.9 million shares of preferred stock.

Preferred stock issued to creditors will be voting stock.

Shareholders will be asked to approve changes in the capital structure to authorize new classes of preferred stock contemplated to be issued under the proposed plan.

We anticipate that the plan will be presented to creditors and shareholders for approval within the next several months.

As authorized by the Board of Directors, the audit committee comprised of non-management directors, has studied the Price Waterhouse & Co. report on related parties and claims and suits filed concerning the former management of the Company, and with the advice of counsel, is currently considering appropriate action. The Directors felt that basic decisions with regard to such matters and with respect to litigation should be made by directors not associated with the active management of the Company.

The seventeen months that have elapsed since I joined the Company have seen many changes.

We have taken important steps in building for the Company's long-term future. We have almost completely restructured our corporate and operating management staff with able, professional executives, and we have brought to our Board of Directors individuals who have distinguished themselves in business and government. You will find brief biographies of these persons beginning on page 29.

In addition, we have restored credibility and confidence with our trade and other creditors and initiated programs to correct deficiencies in the Company's systems of internal accounting control and record-keeping which contributed significantly to the delay in completion of our financial statements for Fiscal 1979.

My summary to a recent presentation I made to a conference of financial executives of the Food Marketing Institute is a fitting conclusion to this report on your Company's status:

> "If Chapter XI is, indeed, a journey, we appear to be nearing our destination. As that comes to pass, the shareholders, that long-suffering group in the Chapter XI process, will again come into the picture. There are many who have contributed to this achievement. I am grateful to all of them and feel enriched by my association and the experience itself, and by being part of one of the largest Chapter XI reorganizations in history. It has, indeed, been and continues to be, a great adventure. The final chapters remain to be written."

And may I add my appreciation of shareholders' understanding and support. I assure you of management's continued efforts to make this Company again strong, proud and profitable.

Sincerely,

Grant C. Gentry
Chairman/President
Chief Executive Officer

June 27, 1980

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Fiscal Year Ended	**Commission File No.**
July 28, 1979	**1-2956**

FOOD FAIR, INC.

(Exact name of Registrant as specified in its charter)

Pennsylvania	**23-1172640**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employee Identification No.)**

6500 North Andrews Avenue, Fort Lauderdale, Florida 33309

(Address of Principal Executive Office)

Registrant's telephone number, including area code: (305) 771-8300

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered*
8⅜% Sinking Fund Debentures Due January 15, 1996	None*
4% Subordinated Debentures Due April 1, 1979	Philadelphia Stock Exchange*
Common Stock, $1 par value	Philadelphia Stock Exchange* Pacific Stock Exchange*

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed with the Commission by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.

Yes ______ **No** x

7,358,277

Number of Shares of Common Stock Outstanding as of July 28, 1979

*See "Delisting of Securities" under Item 1.

QUALIFICATION

THIS ANNUAL REPORT IS SUBJECT TO SIGNIFICANT QUALIFICATIONS AS DESCRIBED HEREIN. THE REGISTRANT'S INDEPENDENT PUBLIC ACCOUNTANTS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS CONTAINS A DENIAL OF AN OPINION. CERTAIN OF THE INFORMATION NORMALLY REQUIRED BY FORM 10-K UNDER THE SECURITIES EXCHANGE ACT OF 1934 IS NOT AVAILABLE TO THE REGISTRANT. ALTHOUGH MANAGEMENT HAS MADE REASONABLE EFFORTS TO ASSURE THE ACCURACY IN ALL MATERIAL RESPECTS OF THIS REPORT, THIS REPORT IS FILED IN RELIANCE ON RULE 12b-21 UNDER SAID ACT WHICH PROVIDES THAT INFORMATION NEED BE GIVEN ONLY INSOFAR AS IT IS KNOWN OR REASONABLY AVAILABLE TO THE REGISTRANT.

Item 1. *Business*

Food Fair, Inc. (which together with its subsidiaries is hereinafter sometimes referred to as the "Company") presently operates a chain of retail food supermarkets in the Baltimore, Maryland, Norfolk-Richmond, Virginia and Jacksonville and Miami, Florida areas under the "Pantry Pride" and "Food Fair" names, and related food manufacturing and processing businesses which supply its supermarket operations as well as sell to third parties. The Company also operates certain non-food retail and wholesale operations, and conducts various miscellaneous operations, including a life insurance company. Since October 2, 1978, the date petitions were filed under Chapter XI of the Bankruptcy Act (see "Chapter XI Arrangement Proceedings" below), the Company has terminated its supermarket operations in the Pennsylvania, New Jersey, New York, Connecticut, and Tampa, Florida areas, discontinued its J. M. Fields discount department store operations, closed its meat processing and certain produce operations, and embarked upon a program for the disposition of real estate and other assets unrelated to its continuing operations.

CHAPTER XI ARRANGEMENT PROCEEDINGS

Background

On October 2, 1978, the Company and nine of its subsidiaries including J. M. Fields, Inc., Hills Supermarkets, Inc. (then operating certain supermarkets in the Long Island, New York area) and Newcorp Supermarkets, Inc. (then operating certain supermarkets in the Philadelphia area) filed petitions under Chapter XI of the Bankruptcy Act with the Clerk of the United States District Court for the Southern District of New York seeking an arrangement of their respective unsecured indebtedness and liabilities. (Index Nos. 78 B 1764-1773). The cases were referred for all purposes to Bankruptcy Judge John J. Galgay (hereinafter referred to as the "Court"). (See Report on Form 8-K dated October 10, 1978, with respect to events occurring on October 2, 1978). On that date, the Court issued its order authorizing the filing corporations to continue operations as debtors in possession.* Since the filings were made under the then effective Bankruptcy Act, the Chapter XI Proceedings are not subject to the new federal Bankruptcy Code that became effective in October, 1979.

By the late spring of 1978, shortages of working capital and increasingly late payments to suppliers resulted in the imposition by suppliers of increasing restrictions on the credit terms on which the Company was purchasing merchandise. These restrictions in turn resulted in serious understocking conditions at many of the Company's stores, with a resulting adverse impact on revenues and profitability. In order to bolster trade credit, the Company, in June, 1978, initiated discussions with its principal bank lenders with a view to obtaining a $28 million loan to assist in the reduction of overdue trade payables and to obtain restoration of normal trade credit. Negotiations for this loan were protracted and the funds were not made available until August, 1978. During this period supplier relationships were strained; and despite substantial payments to suppliers that were funded by the loan, normal credit terms continued to be denied to the Company, worsening the out-of-stock conditions at many stores and leading to an erosion of customer goodwill, with further adverse impact on sales and working capital. The Company also found itself unable to extend short-term bank loans as they fell due, and, between the beginning of the 1979 fiscal year, i.e. July 30, 1978, and October 2, 1978, paid off $3,300,000 of such loans, further eroding the Company's working capital position. On the date of the filing of the Chapter XI petition, an additional $700,000 of such loans were to become due without prospect of extension. Estimated losses from operations were believed by then to have reduced the Company's net worth below that required to be maintained under the Company's loan agreements with certain lenders. For this as well as other reasons, all of the Company's institutional indebtedness would likely have become immediately due under the terms thereof, in which event the Company would have been faced with the prospect of having its bank accounts set off against outstanding indebtedness.

* The proceedings in Chapter XI for Food Fair, Inc. and its subsidiaries have been procedurally consolidated and are being jointly administered under Docket 78-B 1764 under the caption "In Re J. M. Fields, Inc., Food Fair, Inc., et al, Debtors" and are hereinafter referred to collectively as the "Chapter XI Proceedings."

In its petition for an arrangement under Chapter XI, the Company cited as the reasons for its financial difficulties (a) the parent company's advances to J. M. Fields, over the past three to five years, of in excess of $100,000,000 to cover losses sustained by the Fields chain, (b) the emergence of increased competition in traditionally strong supermarket areas, (c) the cash drain caused by Fields, which left insufficient cash available in the supermarket divisions to purchase inventories in sufficient quantity to obtain maximum discount levels and thus, increased gross profit margins, (d) loss of volume in the supermarkets by reason of their inability to fully stock and thereby effectively compete with competitors, (e) inability to obtain normal credit terms from suppliers and (f) the existence of internal administrative problems which resulted in lack of accurate reporting control over payables and receivables.

Significant Events Subsequent to Institution of Chapter XI Proceedings

Since the commencement of the Chapter XI Proceedings, significant changes have occurred in the business, management and operations of the Company. These include: (i) the resignation of most of the members of former senior management and the appointments of Grant C. Gentry as Chairman of the Board, President and Chief Executive Officer, and of other new executive personnel (see "Management Changes" below); (ii) the retention of Touche Ross & Co., independent public accountants and management consultants, to assist management in its design of a viable operating structure for Food Fair, to generally assist in the Company's reorganization and to audit the Company's financial statements and make recommendations relative to operating and financial controls; (iii) the termination of all supermarket operations in the New York, Connecticut, New Jersey, Pennsylvania and Tampa, Florida areas, resulting in the closing of an aggregate of 222 stores (see "Continuing Operations" and "Terminated or Discontinued Operations" below); (iv) the discontinuance of the J. M. Fields discount department store operations; (v) the closing of the Company's meat processing and certain produce operations; (vi) the institution of a disposition program covering real estate and other assets unrelated to the Company's continuing operations; (vii) the payment, without prejudice, by the Company in May, 1979 of a $28 million secured loan, together with approximately $2.4 million of accrued interest, which was obtained in August, 1978 from certain bank lenders, and in October, 1979 of approximately $11,600,000 representing a portion of an amount advanced by a certain bank lender pursuant to an accounts receivable financing (see Item 6 below); and (viii) the relocation of the Company's executive offices from Philadelphia to Fort Lauderdale, Florida, a location more central to the Company's continuing operations.

On September 26, 1979 and October 4, 1979, the Official Creditors' Committees and the Court, respectively, approved the Company's proposed five-year Capital Improvements Program. The program, which involves the expenditure of approximately $205 million, is intended to enable the Company to remodel and expand its supermarket facilities. It is contemplated that $35.5 million will be expended under the program during the 1980 fiscal year, including $25 million from funds previously restricted in the Chapter XI Proceedings. The balance of the Capital Improvements Program must be funded through external financings not now arranged and through continuing operations.

Proposed Plan of Arrangement

On September 26, 1979, the Official Creditors' Committees approved the principal elements of a plan of arrangement which were filed with the Court on October 4, 1979. In developing a complete plan in cooperation with representatives of creditors, revision of the original elements became necessary, principally as a result of the excess of liabilities over assets at the July 28, 1979 fiscal year end being substantially in excess of prior estimates, delays in disposing of assets not related to ongoing operations and substantial reduction in anticipated proceeds therefrom. The revised elements were approved by a majority vote of the Official Creditors' Committees on April 28, 1980, and the Company filed the proposed Plan of Arrangement (the "Plan") based on such elements with the Court on May 7, 1980. Representatives of food trade creditors (included among Class 1 claims) voted against the Plan and have indicated their intention to issue a dissenting report. The Plan is predicated upon a substantive consolidation of the Chapter XI Proceedings.

A copy of the Plan was filed with the Securities and Exchange Commission as an Exhibit to the Company's Report on Form 8-K dated May 9, 1980, with respect to events occurring on May 7, 1980, which Report is hereby incorporated by reference. Reference is made to that exhibit for a complete

See "Qualification" on Cover Page

statement of the terms of the Plan and the description set forth below is qualified in its entirety by that reference. Words capitalized in the description have specific definitions in the Plan.

Under the Plan, the Company is obligated to pay its creditors, whose claims are divided into the classes described below, the following:

(a) Disposition Proceeds (net amounts realized from sales of assets not related to ongoing operations).

(b) $10,000,000 annually ("Fixed Payments") beginning after Confirmation and continuing through a period (the "Payment Period") of 16 years beginning no later than January 15, 1985 after cash payments of 45% of claims have been paid to Class 1 and Class 2 creditors and 5% of claims has been paid to Class 3 creditors, plus an additional $3,500,000 in the sixteenth year.

(c) A "Contingent Payment" of 50% of Excess Cash Flow for the Payment Period. Excess Cash Flow is essentially the Company's funds in excess of those committed to the Capital Improvements Program, payments under the Plan and the 3% of sales deemed to be the current operating cash requirement of the Company. A "Contingent Payment" of up to an additional 50% of Excess Cash Flow may also be required in certain years if Class 1 creditors have not received payments equaling 75% of their claims.

The cash to be paid out by the Company will be applied during the 16 year Payment Period to retirement of and dividends on the following Preferred Stock also to be issued to Class 1, 2 and 3 creditors following the date the Court confirms the Plan ("Confirmation"):

Liquidating Preferred Stock (nondividend bearing) to be liquidated for $10 per share at the rate of $10,000,000 per year over the first 9 years of the Payment Period, to be issued as follows:

4,380,000 shares of Series A to Class 1 creditors
4,080,000 shares of Series B to Class 2 creditors
540,000 shares of Series C to Class 3 creditors

Class A Convertible Preferred Stock, bearing dividends during the Payment Period at rate of $1 per share for 14 years, with adjustment for unpaid dividends, convertible into approximately 4,400,000 shares of Common Stock, and redeemable for $10 per share plus accrued dividends to be issued as follows:

3,500,000 shares (estimated) to Class 2 creditors

Class B Preferred Stock, bearing dividends during the Payment Period at rate of $.50 per share for 14 years and $1 per share thereafter, with adjustment for unpaid dividends, to be issued as follows:

1,934,000 shares to Class 3 creditors

Additional shares of Class A and Class B Preferred Stock will be distributed to holders of Class 2 and Class 3 claims to reflect loss of present value due to delay in starting the Payment Period. All Class A and Class B Preferred Stock outstanding at the end of the Payment Period will be automatically converted into shares of common stock of Food Fair, Inc. having the same ratio to total outstanding common stock after such conversion as the then aggregate redemption price of such Preferred Stock bears to the excess of consolidated assets over consolidated liabilities (not including Preferred Stock in such liabilities).

In addition, an aggregate of approximately 2,200,000 shares of common stock will be issued to Class 3 creditors.

Under the Plan, the Company's cash payments and issuances of securities will be made to the creditors in the various classes as follows:

Priority, administrative and union and employee related claims	Total claims: Approximately $80,000,000—unpaid balance of approximately $35,000,000 to be paid in cash in full prior to or on the Consummation Date (scheduled to take place not later than 31 days after Confirmation).

See "Qualification" on Cover Page

Class 1 (generally trade creditors excluding amounts included in Class 4)	Total claims: Approximately $200,000,000—to receive 25% of claims on the Consummation Date, an additional 5% not later than March 31, 1981 and an additional 15% by January 15, 1985. Class 1 creditors will also receive approximately $43,800,000 in Liquidating Preferred, Series A to be liquidated at the rate of $7.3 million per year in the first six years of the Payment Period. In addition the Class 1 creditors will receive a pro-rata share of 50% of Excess Cash Flow in the first six years of the Payment Period and to the extent necessary to achieve a total payment of 75% of claims will receive the Company's 50% of Excess Cash Flow in the years 7 through 9 of the Payment Period.
Class 2 (non-subordinated lenders, principally banks and holders of 8⅜% Debentures due 1996, excluding amounts included in Class 5)	Total claims: $105,000,000 to $110,000,000—to receive 25% of claims on the Consummation Date, an additional 5% by March 31, 1981 and an additional 15% by January 15, 1985. Class 2 creditors will also receive $40,800,000 of Liquidating Preferred, Series B to be liquidated at the rate of $2,100,000 per year in the first six years of the Payment Period and $9.4 million per year in years 7 through 9 of the Payment Period. In addition Class 2 creditors will receive 3,500,000 (estimated) shares of convertible preferred Class A stock. Class A Preferred holders are to receive in dividends and for redemption $9.4 million per year in years 10 through 14 of the Payment Period.
Class 3 (subordinated lenders, including holders of 4% Debentures due 1979)	Total claims: $28,100,000—to receive the lesser of 1% of Available Cash or 5% of Claims on the Consummation Date, not less than 3.33% of Claims by March 31, 1981 and an additional 1.67% by January 15, 1985. On the Consummation Date Class 3 creditors will also receive 2,200,000 shares of Common Stock, $5,400,000 of Liquidating Preferred, Series C to be liquidated at the rate of $600,000 per year through the first 9 years of the Payment Period, and 1,934,000 shares of Class B Preferred Stock. Class B Preferred holders are to receive in dividends and for redemption $600,000 per year in years 10 through 14 and an aggregate of $23,500,000 in years 15 and 16 of the Payment Period.
Class 4 (claims based on receipts of merchandise in period September 27, 1978 to October 1, 1978)	Limited to $13,400,000, to be paid on the Consummation Date the lesser of 100% or a pro-rata portion of $13,400,000 with the balance of such claims being included in Class 1.
Class 5 (bank overdrafts in period September 27, 1978 to October 1, 1978)	Limited to 60% of overdrafts and aggregate claims not to exceed $3,600,000 to be paid on the Consummation Date with the balance of such overdrafts being included in Class 2.
Class 6 (claims of Class 1 creditors of $350 or less and those accepting $350 in full settlement)	Estimated at less than $1,000,000 to be paid on the Consummation Date.

See "Qualification" on Cover Page

Class 1 creditors may elect to be treated as Class 2 creditors, and Class 2 creditors may elect to be treated as Class 1 creditors, but crossovers into Class 1 shall not exceed crossovers into Class 2 and the amount of crossovers into Class 2 may not exceed by more than $25,000,000 crossovers into Class 1 claims. To the extent that there are crossovers into Class 2, amounts to be distributed on Class 1 claims shall be proportionately reduced and distributed to Class 2 creditors. Amounts of claims in Classes 1 and 2 and securities to be delivered to each shown above have assumed no elections for cross-over treatment by creditors.

Fifty percent of Excess Cash Flow will be distributed pro-rata to Class 1 creditors and holders of Class A and Class B Preferred Stock during the first 6 years of the Payment Period, pro-rata to holders of Class A and Class B Preferred Stock during years 7 through 14, and pro-rata to holders of Class B Preferred Stock in years 15 and 16 (such distributions to holders of Preferred Stock being first to pay current and past dividends and then to redemption).

The operation of the Plan and the distribution to be made to creditors in the various classes in the Plan depend on the determination of the amount of claims filed and allowed in each class. Since substantial claims are either unliquidated or disputed, or may involve election by the creditors or decisions by the Company not yet made (e.g. disaffirmation of leases), the amount of the claims and the amount of securities to be issued in certain cases cannot now be determined. Accordingly, the amounts of claims and cash to be paid or securities to be issued to various creditors shown as estimates or ranges in the foregoing summary of the Plan could vary on final determination.

The proposed Plan contains covenants which, among other matters, (i) require the Company to maintain specified levels of consolidated tangible net worth, as defined; (ii) limit purpose and amount of additional indebtedness that can be incurred; (iii) restrict the payment of cash dividends; and; (iv) limit the extent to which the Company may acquire or dispose of specified assets.

The Plan will require the approval by a majority in number and amount of each class (as described above and more specifically defined in the Plan) of the Company's unsecured creditors, who have filed claims and are eligible to vote, and must, among other things, be found by the Court to be feasible and in the best interests of the creditors within the meaning of the Bankruptcy Act. In addition, certain actions necessary to implement the Plan, namely the amendment of the Company's Restated Articles of Incorporation to authorize the new classes of preferred stock contemplated to be issued under the proposed Plan, must be approved by the Company's stockholders. The Company presently anticipates that it will present the proposed Plan to its creditors for their requisite approvals and the implementing actions for stockholder approval within the next several months. Should the Plan not be accepted by the creditors and confirmed by the Court, or should the Company's stockholders fail to adopt all the necessary implementing actions, the Company could be adjudicated a bankrupt and its assets liquidated, or the Chapter XI Proceedings could be transferred to proceedings under Chapter X of the Bankruptcy Act, in which event control would pass to a court-appointed trustee. In the event of either bankruptcy or Chapter X proceedings it is expected that the Company's stockholders would receive nothing.

The performance of the Plan is also dependent upon the Company having sufficient cash available to make the initial payments, and upon continued generation of sufficient cash from ongoing operations to meet the periodic payments required by the Plan and upon certain other contingencies. See Note 1.2 of notes to consolidated financial statements and "Related Party and Other Investigations—PACA License—Possible Suspension." The Company believes that such payments can be made from the combination of disposition proceeds, other cash generating programs, temporary financings, and temporary diversion of cash committed to operations or capital programs, but there is no assurance the payments can be so accomplished. See also "Terminated or Discontinued Operations—Application of Proceeds of Asset Dispositions" with respect to claims of creditors of subsidiaries to a portion of disposition proceeds.

Accounting and Financial Disclosure Developments

As Food Fair's new management was being organized during 1979, the presence of significant preexisting and continuing deficiencies in the Company's systems of internal accounting controls and recordkeeping became increasingly evident. These deficiencies and management's ability to respond thereto were significantly impacted by the dislocations engendered by the Company's pending Chapter XI Proceedings, including the closing and liquidation of approximately two-thirds of the preexisting business operations, the significant turnover in management, financial and accounting personnel, and the critical need for senior management to focus much of its efforts on business liquidations, identification and re-establishment of a profitable enterprise, and development of a plan of arrangement acceptable to the Company's unsecured creditors. Out of necessity, temporary systems were developed for handling of accounts payable and cash, during the disruptions following the institution of the Chapter XI Proceedings and the closing and liquidation of major operations.

In response to these deficiencies and to replace temporary systems with more permanent ones, the Company initiated and continues efforts to assemble a new financial and accounting management group of greater depth; restructured its internal accounting organization; improved its management reporting systems; reconstituted the Audit Committee of its Board of Directors and started to develop a new internal financial reporting package and an accounting policy and procedure manual. In addition, it acquired the electronic data processing assets of a firm that previously provided this function to the Company in order to develop an EDP function better capable of assisting in the design of new accounting and operating systems.

Notwithstanding the efforts made, a number of material deficiencies continued to exist in the Company's systems of internal accounting controls and recordkeeping at the end of its 1979 fiscal year, i.e. July 28, 1979, many of which were discovered and documented in connection with the audit of the Company's consolidated financial statements for that year. These deficiencies generally included certain organizational weaknesses; the lack or inadequacy of certain systems, procedures and controls, or the documentation with respect thereto; and the inability to locate certain pertinent books and records (which inability is believed to be related to physical relocations of records and departure of large numbers of accounting personnel familiar with such records and their location). In addition to actions previously taken or initiated, management is developing, initiating and implementing a plan to strengthen and improve accounting systems, recruit and hire additional financial management personnel, review and revise operating budgets on an ongoing basis, strengthen and improve financial policies and controls, improve data processing support to all areas, monitor and manage cost reduction programs, and improve record retention and storage. This plan covers the areas in which the Company and its independent auditors have discerned significant deficiencies in internal accounting controls. Also, a new financial systems staff has been assembled whose primary functions will be to strengthen the Company's systems of internal accounting controls. In addition, an internal audit function is being reestablished.

As a result of the preexisting and continuing deficiencies in the Company's systems of internal accounting controls and recordkeeping, the consolidated financial statements for the fiscal year ended July 28, 1979 included in this report (i) omit certain disclosures required by generally accepted accounting principles and (ii) include certain charges to fiscal 1979 operating results that in part do or may pertain to operation of prior and/or future years. Furthermore, the Company's current independent auditors have reported that these deficiencies have prevented their completing tests of accounting records and other audit procedures they considered necessary in order to comply with generally accepted standards. See report of Touche Ross & Co. and Note 2 of notes to consolidated financial statements.

A report of Laventhol & Horwath has not been included herein with respect to the Company's consolidated financial statements for the fiscal year ended July 29, 1978, since the Company has been informed by Laventhol & Horwath that certain new information provided to Laventhol & Horwath may have an effect on their report. The Company anticipates that a report will be issued. Reference is made to the Company's Annual Report on Form 10-K, dated June 15, 1979, for the fiscal year ended July 29, 1978, for the auditors' report dated March 9, 1979 of Laventhol & Horwath contained therein which disclaimed any opinion on the Company's 1978 fiscal year consolidated financial statements.

See "Qualification" on Cover Page

Current senior management, assisted by Touche Ross & Co., conducted a review to determine the effects of certain 1978 fiscal year adjusting journal entries on previously reported unaudited quarterly financial information. Based upon the results of this review it is apparent that the unaudited 1978 quarterly financial information previously issued by the Company was inaccurate, and further that it would be impracticable, if not impossible, to restate that information (See Report on Form 10-K for the fiscal year ended July 29, 1978.) In addition, management has determined that any attempt to generate reliable quarterly financial information for either of the first two quarters of the 1979 fiscal year would involve unreasonable effort and expense and, in fact, would be impracticable, if not impossible. This situation resulted from the Company not closing its books or attempting to prepare financial statements at the end of and with respect to the first quarter of the 1979 fiscal year due to the dislocation engendered by its filing of the Chapter XI petitions on October 2, 1978 and the subsequent closing during that period of a substantial part of the Company's supermarket operations, i.e. the stores in the New York and Connecticut areas. The subsequent substantial changes in the Company's business operations and in its management and internal accounting personnel, together with the absence of certain critical closing data, including cut offs, account analyses and reconciliations with respect to that period, further complicated the problem. Furthermore, the deficiencies in accounting systems and recordkeeping described above have prevented management from being able to assess the effect that numerous year end adjustments had on previously issued fiscal 1979 interim financial data. (See Note 17 of notes to consolidated financial statements.)

OPERATIONS

At the time of the commencement of the Chapter XI Proceedings on October 2, 1978, the Company was the nation's eighth largest supermarket chain and the sixteenth largest retailer, based upon published statistics, and employed approximately 31,000 people. However, as a consequence of actions taken following commencement of those proceedings the Company has been significantly reduced in size. (See "Terminated or Discontinued Operations")

The Company now continues only as a unitary segment, and therefore, segment information presented in accordance with Statement of Financial Accounting Standards No. 14, "Financial Reporting for Segments of a Business Enterprise" is not meaningful and has not been presented herein. Prior years segment information for the now discontinued J. M. Fields discount department store operations is included in Item 1 of Form 10-K for the year ended July 29, 1978.

CONTINUING OPERATIONS

Supermarket Operations

As of April 25, 1980, the Company was operating an aggregate of 204 supermarkets located in Florida (123), Maryland (48), Delaware (7), Virginia (19), and Georgia (7), as compared to the 442 stores in operation at July 29, 1978. After the commencement of the Chapter XI Proceedings the Company closed 222 stores in its New York, Connecticut, Pennsylvania, New Jersey and Tampa, Florida areas, 210 of which were closed pursuant to specific court approval as described below. In addition, 28 stores were closed in the ordinary course of business since July 29, 1978. During the same period the Company opened 9 new supermarkets; and on an experimental basis, it has opened 3 "Best Buy" stores in the Jacksonville region which stores are limited line, minimum service operations. On March 28, 1980, the Company acquired from The Grand Union Company 4 additional supermarket locations in the Baltimore, Maryland area.

The Company's supermarkets conduct their business on a cash-and-carry basis, selling a broad range of food and other products customarily sold in large American food supermarkets. The stores advertise through local newspapers, radio, television, hand-delivered and mailed circulars and by local promotions on a store-by-store or regional basis.

Virtually all of the Company's supermarkets are free-standing units or part of shopping centers, in most cases with adequate off-street parking adjacent to the store. Store sizes generally range from 12,000 square feet to 42,000 square feet. Overall store sizes average 23,000 square feet with an average selling area of 16,000 square feet. Virtually all of the Company's supermarkets are of the price competitive variety, emphasizing low prices to the customer and seeking to offset low gross profit margins with increased sales volume.

All of the Company's stores have sufficient "back-room" warehousing space to meet day to day restocking needs. In addition, the Company maintains various food distribution centers which, at April 25, 1980, aggregated approximately 1,120,000 square feet. The distribution centers are located in Jacksonville and Miami, Florida and Baltimore, Maryland.

The Company also operates various food manufacturing and processing facilities. These include facilities for baking, coffee roasting, soft drink bottling, the packaging of tea and tea bags, and the manufacture of powdered drink mixes, including iced tea mix and an artificial cream product. The Company's supermarket operation is a major customer for the products of these facilities. However, significant sales are also made to third parties. Although the closing during the 1979 fiscal year of 234 supermarkets has had an adverse impact on these operations, the Company presently considers them to be viable and intends to retain them.

Other Continuing Operations

The Company, through various subsidiaries (the "Footwear Operation"), presently distributes branded footwear to approximately 3,600 supermarkets and drugstores through a network of 20 franchised distributors and through individual sales representatives. The Footwear Operation holds licenses in the United States to market footwear under the "Fruit of the Loom" trademark and children's footwear under "Looney Tunes" cartoon character trademarks. The "Fruit of the Loom" license presently expires on December 31, 1980, the Company having exercised the first of four two-year options to renew the license; and the "Looney Tunes" license expires June 30, 1981, the Company having the option to extend it for an additional two years. The Company's 1979 wholesale sales were approximately $10,000,000.

The Company also presently operates nine retail shoe outlets in the eastern part of the United States. Prior to the discontinuance of the Company's J. M. Fields discount department store operations, the Footwear Operation had operated shoe departments in all these stores. Its 1979 retail sales from the Fields stores locations accounted for approximately 90% of its total retail sales volume of approximately $13,600,000 for that year.

The Company owns Washington Square Life Insurance Company, a legal reserve life insurance carrier chartered in the Commonwealth of Pennsylvania and authorized to do business in eleven states. Washington Square sells a full line of life insurance policies through a staff of licensed agents both to the Company's employees and unaffiliated persons. In the most recent fiscal year approximately 73% of Washington Square's annual premium income was derived from employees of the Company and its subsidiaries. The closing of 234 supermarkets and the discontinuance of the J. M. Fields department store operation during that year has had an adverse effect on Washington Square. The significant amount of policy cancellations experienced during 1979 from employee terminations resulted in accelerated amortization of a substantial amount of deferred policy acquisition costs. During the 1979 calendar year, Washington Square incurred a loss of $557,000 as compared to net income of $508,000 for 1978.

Competition

The Company's supermarkets have generally been located in areas characterized by a high degree of competitiveness among supermarket operators. The supermarket operating areas which the Company terminated during the 1979 fiscal year operated unprofitably in recent years in large measure because of particularly intense competitive conditions. However, the divisions which the Company is continuing to operate also face considerable competition. Among its major competitors in the areas of continuing operations are The Great Atlantic and Pacific Tea Company, Winn-Dixie Stores, Inc., Publix Markets, The Grand Union Company, Colonial Stores, Inc., Safeway Stores, Inc., and Giant Stores.

A significant competitive factor is the physical condition of Company stores as compared to those of competitors. In recent years the Company has lacked adequate cash and credit resources to support a full-scale program of store modernization and new store openings in its profitable market areas. In order for these areas to maintain profitability, it is believed to be essential that the Company have sufficient working capital and access to sufficient financing to permit it to conduct a capital improvements program. On October 4, 1979, the Court, with the support of the Official Creditors' Committees, approved the Company's proposed five-year Capital Improvements Program and authorized the use of

$25 million in disposition proceeds to initiate the fiscal 1980 portion of the program. There can be no assurance, however, that the Company will be in a financial position to carry out the remainder of this program.

The Company engages from time to time in price promotional activities involving price reductions in its supermarket operations. Competitors of the Company run similar promotional campaigns. A promotional campaign can have adverse effects on profitability locally or nationally depending on the size and financial resources of the competitor running it and its duration. Normally, the effects of any such promotion are temporary.

The Company expects it will continue to face the traditional severe competition of the retail supermarket industry, which operates on a high volume, low profit margin basis. A particularly aggressive new form of competition now being encountered is limited-line, minimum-service merchandise operations that generally concentrate on staple consumer items.

Employee Relations

At April 25, 1980, the Company employed approximately 11,000 persons and had contracts with various unions covering wages, hours of employment, and other conditions of employment of certain employees. The Company considers that its labor relations with its ongoing employees and unions are satisfactory.

The Company maintains pension plans for certain of its salaried and hourly-rated employees, and it contributes to various Taft-Hartley multi-employer pension plans, jointly maintained by industry and union, covering certain other hourly-rated employees. The Company engaged independent actuaries to review the effects the closings and discontinued operations will have on the pension plans and the Company's liabilities thereunder. The actuaries have estimated such liabilities to total approximately $856,000.

In addition, the Company is a "substantial employer" with respect to two multi-employer pension plans covering employees in its closed Philadelphia area stores and five stores in the Wilmington, Delaware area which have remained open. The Company does not believe it has "withdrawn" from such plans under the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). The actuaries, using the available but incomplete data, reported that if the Company were held to have withdrawn from such plans, the potential liability of the Company in the event of future termination of the plans would be approximately $14,000,000, for which the Company could be required by the Pension Benefit Guaranty Corporation to post a 150% bond. The Trustees of such plans have filed claims in the Chapter XI Proceedings (which are not based upon any specified provisions of ERISA), totaling approximately $50,000,000, in general purporting to represent the Company's proportionate share of plan liabilities. The Company has filed objections to such claims in their entirety alleging their insufficiency as a matter of law. Counsel has advised that discovery proceedings with respect to the Company's objections are in an early stage and the basis and actuarial assumptions for the amount of such claims has not yet been revealed or analyzed. The Company has also filed objections, alleging insufficiency as a matter of law, to a claim for unfunded benefits in the amount of $5.5 million, filed by a third multi-employer plan with respect to which the Company was not a "substantial employer" and would therefore not have potential plan termination liability under ERISA. Proposed legislation introduced in Congress would amend ERISA to provide, under certain circumstances, for direct employer liability for continuing contributions to multi-employer plans from which the employer had withdrawn or partially withdrawn. There are substantial variations in the various bills proposed concerning the circumstances in which a partially withdrawing employer would remain liable to a multi-employer plan, but each bill would generally require, with respect to a covered employer, that contributions be continued at levels measured by contribution levels existing before the date of partial withdrawal. It is not possible at this time to determine whether legislation finally adopted, if any, will have a retroactive effect upon the Company.

TERMINATED OR DISCONTINUED OPERATIONS

As a result of the Chapter XI Proceedings and pursuant to a strategy of continuing to operate only in those areas, both business and geographic, where it has historically experienced profitability, the Company terminated its supermarket operations in the Pennsylvania, New Jersey, New York, Connecticut, and Tampa, Florida areas; discontinued its J. M. Fields discount department store operations; and closed its meat processing and certain produce operations. The Company is in the process of disposing of its interests in properties related to those operations and in any other properties and assets not essential to its ongoing business. Proceeds from the dispositions will be primarily applied to the Company's obligations under the proposed Plan of Arrangement and used to fund a portion of the Company's Capital Improvements Program and pay certain secured indebtedness. As of March 8, 1980, the Company has realized from such dispositions aggregate proceeds, net of related mortgages, costs and expenses, of approximately $142,000,000. The additional amounts to be realized from the disposition program, net of sale expenses, carrying costs, related indebtedness and other costs, is uncertain since a significant portion of the properties have not yet been sold, and the timing of and amounts to be realized from future sales are subject to general economic conditions and other factors not within the control of the Company. However, the Company currently estimates net additional proceeds at between $25,000,000 and $35,000,000. The net amount to be realized from the disposition program is less than the aggregate of the historic values prior to July 28, 1979 that have been attributed to the pertinent properties, other assets and deferred charges on the Company's books.

Termination of New York, Connecticut, Pennsylvania, New Jersey and Tampa, Florida Supermarket Operations

On November 1, 1978, the Court authorized the Company to close 89 supermarkets located in New York and Connecticut. (See Report on Form 8-K dated November 27, 1978, for events occurring in November, 1978.) On January 26, 1979, the Court authorized the Company to close its supermarket operations in the Pennsylvania, New Jersey and Tampa, Florida areas, comprising a total of 121 stores. (See Report on Form 8-K, dated February, 1979 for events occurring in January, 1979). The 1979 fiscal year sales of the terminated supermarket operations, together with revenues of other related closed operations, aggregated approximately $467,300,000, or approximately 31% of the Company's total revenues, and sustained a loss, before unusual items, of approximately $63,600,000.

Discontinuation of J. M. Fields Discount Department Store Operations

On April 17, 1979, the Court authorized the Company to discontinue its J. M. Fields discount department store operations, consisting of 79 department stores located in the eastern United States. These stores operated at a substantial loss during past years. Prior to the discontinuance, in fiscal 1979 the J. M. Fields Division had sales of approximately $143,800,000 (including sales of footwear by another subsidiary of the Company), and a net loss, before corporate overhead and interest expense allocations, of approximately $47,700,000. Prior to the Court's authorization for discontinuation, the Company explored alternative means to accomplish this disposition including sale of the entire operation as a going business. Efforts to find a qualified buyer for the entire division as an operating unit were unsuccessful and, therefore, the Company, with Court approval, ceased operation of the stores and entered into arrangements for the liquidation of the stores' inventory and sale of the related real estate interests and other assets.

Other Closed Operations

In addition, since commencement of the Chapter XI Proceedings, the Company has closed its cattle feedlot and meat processing operations and its northern produce operations. The various other ancillary activities of the Company have been reviewed to determine whether the projected results of their operations over the foreseeable future warrant their retention. This review considered, among other factors, the Company's investment therein, the estimated realizable proceeds upon any disposition, the Company's overall managerial and systems capabilities and resources and the impact of disposition upon the Plan and the Company's ability to fulfill its obligations thereunder.

Dispositions of Assets

The Company is engaged in the process of liquidating and disposing of the real estate properties and other assets related to the above mentioned closed or discontinued operations as well as its leasehold or residual interests in approximately 200 additional properties unrelated to the Company's ongoing operations. These properties include other vacant discount department store and supermarket locations, warehouse facilities, manufacturing plants, the former headquarters building in Philadelphia and unimproved real estate, located along the eastern seaboard of the United States and in California and the Bahamas.

With Court approval, the Company retained the services of two real estate brokerage firms, Stone-East Associates, Inc. and Eastdil Realty, Inc. (a subsidiary of Paine Webber, Inc.), to assist in the disposition of its real estate interests and related fixtures and equipment. Also, with Court approval, professional liquidators were retained to handle the liquidation of the J. M. Fields and certain closed supermarkets' inventories.

As of March 8, 1980, the Company had sold 247 properties, including 169 where it held a leasehold interest and 78 where it owned the residual interest. Also, as of that date the Company had contracts for the sale of 54 additional real estate properties in which it held a leasehold or residual interest calling for gross proceeds aggregating approximately $29,000,000 over and above mortgages to be paid on closing. In addition, 69 leases had been terminated or disaffirmed by the Company as of March 8, 1980. (Under Sections 313(1) and 353 of the Bankruptcy Act the Company is permitted to disaffirm leases and thereby reduce its potential liability with respect to the remaining terms thereof to an amount not exceeding the rent, without acceleration, reserved by each lease for the three years next succeeding the date of the surrender of the premises to the landlord or the date of the reentry by the landlord, whichever first occurs, whether before or after October 2, 1978, plus unpaid accrued rent up to the date of surrender or reentry. Any liabilities arising from disaffirmance would be general unsecured claims encompassed within the Plan.) At July 28, 1979, the carrying amounts of unsold properties, other assets and deferred charges covered by the disposition program were reduced to estimated net realizable amounts. See Note 3 of notes to consolidated financial statements.

Application of Proceeds of Asset Dispositions

Net proceeds derived by the Company from sales or other dispositions of its assets or business, as described above, have been generally required by the Court and informal agreement with the Creditors' Committees to be segregated and set aside for ultimate payment to creditors, rather than for use as working capital.

In November, 1978, the Court ordered that the first $25,000,000 realized from the dispositions be set aside in a special trust fund, to assure payment of obligations of the Company incurred subsequent to October 2, 1978, to persons extending trade or other credit in the event these obligations are not paid in the normal course of business, which funds will become available to effectuate the Plan of Arrangement with creditors. The Court authorized the Company to utilize disposition proceeds to pay without prejudice outstanding secured indebtedness of $28,000,000 plus interest on May 25, 1979 and approximately $11,600,000 on October 29, 1979. (See "Increases and Decreases in Outstanding Securities and Indebtedness.") In addition, on October 4, 1979, the Court and Creditors' Committees authorized the Company to utilize $25,000,000 from sale proceeds in connection with its Capital Improvements Program.

The balance of disposition proceeds is required to be paid to creditors under the terms of the proposed Plan. (See "Proposed Plan of Arrangement".) However, approximately $29,000,000 of said proceeds derived from sales of properties owned by subsidiaries not parties to the Chapter XI Proceedings and are presently being held apart from other funds available to the Company for the purpose of fulfilling the Plan. The Company believes that the creditors of these subsidiaries (whose unpaid balances are approximately $13,000,000) are adequately protected without recourse to the funds currently withheld from the Company, but at this juncture the matter has not been resolved.

Liquidation of Investment in Amterre Development Inc

The Company, through a wholly-owned subsidiary, F. F. Financial Corporation ("FF Financial"), which has also filed a petition under Chapter XI is the record owner and has certain voting rights, de-

See "Qualification" on Cover Page

scribed below, as to approximately 40% (3,333,333 shares) of the outstanding common stock, and all of the outstanding preferred stock, of Amterre Development Inc ("Amterre"), a publicly held developer of shopping centers and other real properties located throughout the eastern United States. FF Financial pledged its Amterre shares to a group of lender banks ("Pledgee Banks") in connection with the $28 million secured loan advanced to the Company in August, 1978. The loan was paid in full on May 25, 1979, but the pledged Amterre shares have not yet been released by the Pledgee Banks.

To date Amterre has not paid any dividends on its common stock. In addition, no dividends have been declared or paid with respect to Amterre's preferred stock for the five quarters ending March 31, 1979 through March 31, 1980. If dividends are not paid for six quarters, the Company would have the right to elect a majority of Amterre's Board of Directors. Amterre has publicly stated, however that it expects to pay sufficient preferred dividends so as not to be more than five quarters in arrears.

As a consequence of the Company's Chapter XI Proceedings, store closings and Amterre's anticipated liquidation, a number of claims and disputes arose among Food Fair, Amterre and their respective subsidiaries. Negotiations among the parties resulted in an agreement dated July 5, 1979, which agreement has been approved by the Court. The agreement provides for substantial changes in the terms of many of the Company's leases with Amterre. In addition, Amterre's claims against Food Fair were settled by offsetting its claims as of May 31, 1979, other than for current rents and charges, virtually in full against amounts it owed to the Company, including prepayment of $864,000 of long-term notes relating to six shopping centers. On September 26, 1979, the Company received payment of the net balance of $650,000 plus interest that remained owing to it under the agreement.

On May 2, 1978, the Board of Directors of Amterre voted to recommend to Amterre's shareholders the adoption of a plan of liquidation and dissolution under Section 337 of the Internal Revenue Code (hereinafter referred to as the "Amterre Plan"). The Amterre Plan is intended to result in Amterre not incurring any federal income tax liability with respect to the proceeds from the disposition of its assets and may result in the payment by Amterre's shareholders, including the Company, of a single capital gains tax on the value of the cash and other assets distributed to them. The Amterre Plan requires the distribution to Amterre's shareholders, within 12 months following adoption of the Amterre Plan, of all of its net assets less any amounts required to be set aside in a reserve against contingent or unliquidated liabilities or claims. The Company has been advised that Amterre is seeking to sell for cash as many of its assets and properties as possible. Stone-East Associates, Inc. and Eastdil Realty, Inc. have also been retained by Amterre to assist with the sales of its properties. Under the Amterre Plan any assets and properties not disposed of within the 12-month liquidation period will be spun off into a limited partnership whose principal objective will be the disposition of such assets and properties. Holders of Amterre common stock would receive limited partnership units on the basis of one unit for each share of common stock held. The Amterre Plan contemplates that a subsidiary of Food Fair will serve as one of the corporate general partners of the limited partnership. It also contemplates among other things, the redemption, at a stated redemption price of $100 per share, of all of the 20,000 shares of Amterre 6% Preferred Stock which are held by the Company.

The Amterre Plan was adopted by Amterre's stockholders at a meeting held on March 21, 1980. At that meeting, it received the requisite approval of a majority of the outstanding shares of Amterre's common stock and preferred stock, each voting separately as a class, and of a majority of its outstanding shares of common stock held by persons other than Food Fair or any officers and directors of Food Fair or Amterre. With Bankruptcy Court approval, the Company voted in favor of the Amterre Plan. The Company has been advised that an initial distribution under the Amterre Plan should not be expected before approximately six months after the date of its adoption.

On November 21, 1978 a stockholder of Amterre filed suit against Amterre and Amterre's directors and the Company seeking, among other matters, to enjoin Amterre's liquidation. Prior to the March 21, 1980 Amterre stockholders meeting, the trial court denied a motion for a preliminary injunction to enjoin the meeting. See "Legal Proceedings".

Amterre operates 50 shopping centers located in Connecticut, Florida, Maryland, New Jersey, New York, Pennsylvania, Virginia and Wisconsin. The Company is presently a supermarket tenant in nine of such shopping centers, and in addition, it remains a lessee of 29 supermarket or department store locations at other Amterre shopping centers which it has vacated, of which eight have been subleased and 21 are vacant. The Company presently operates 13 supermarkets on separate, free-standing premises owned by Amterre, and also remains a lessee at 38 additional supermarket or department store locations which it has vacated of which nine have been subleased and 29 are vacant. The Company is offering for sale its interest in most of its vacant supermarket and department store locations, including those leased from Amterre and others. It is, however, considering the purchase from Amterre of a number of the free-standing premises it presently occupies.

Until November 14, 1978, when the five directors of the Company referred to below in "Management Changes" resigned, a majority of the Board of Directors of Amterre were also directors of the Company. At the present time one Company Director, Roger L. Galassini, is also a member of Amterre's Board of Directors.

MANAGEMENT CHANGES

On November 13, 1978, Jack M. Friedland, President since 1966, and Chief Executive Officer of the Company since 1971, resigned as an officer and director of the Company. Simultaneously, resignations from the Board of Directors were accepted from Messrs. Samuel Friedland, the founder of the Company, Louis Stein, former Chairman and President, Hess Kline, former Vice-President and Treasurer, and Herman Silver, former Vice-President. (Previously, on October 4, 1978, Messrs. Willard S. Boothby, Jr., William P. Davis III and W. Paul Stillman had resigned as Directors.) In connection with their resignations on November 13, 1978, Mr. Friedland and these directors issued statements announcing that their resignations were prompted in part by certain major creditors of the Company and by their desire to remove any obstacles to the successful implementation of a plan of arrangement under Chapter XI. Contemporaneously with such resignations, Marvin Lerner (who subsequently resigned on March 20, 1979) was elected to the position of Senior Vice-President and Chief Operating Officer and served as the senior executive officer of the Company until January 4, 1979, at which time Grant C. Gentry became President, Chief Executive Officer and Chairman of the Board. Mr. Gentry had been a principal of Adamy, Foley and Gentry, Chicago, Illinois, a food industry consulting firm; had previously served for two and a half years as President and Chief Administrative Officer of The Great Atlantic and Pacific Tea Company, a national supermarket chain; and prior thereto had served for 18 years in various positions at the Jewel Companies, Inc., a major regional supermarket chain, ultimately becoming Executive Vice-President and General Counsel. Mr. Gentry has been engaged pursuant to a five-year employment agreement calling for compensation of $350,000 per annum and other benefits. See "Management Remuneration and Transactions".) Since the institution of the Chapter XI Proceedings, the Company has also appointed new chief financial, accounting and administrative executives and other new senior management and operating personnel. (See "Directors and Executive Officers of the Registrant".)

RELATED PARTY AND OTHER INVESTIGATIONS

In August, 1978, as a result of allegations contained in the August 21, 1978 issue of *Forbes* magazine entitled "Is All Fair at Food Fair?" the Audit Committee of the Board of Directors undertook an investigation and analysis of certain transactions between the Company and persons or entities affiliated with the Company's management. The Audit Committee retained special counsel and auditors to assist it. On October 4, 1978, each of the directors serving as members of the Audit Committee resigned for the stated reason that, given the Chapter XI filing, he would be unable to devote sufficient time to fulfill his duties as a director of the Company.

Subsequent to the formation of the Official Creditors' Committees, the investigation was reactivated, and with Court approval, Price Waterhouse & Co., an independent accounting firm, was retained to conduct it. With Bankruptcy Court approval Price Waterhouse retained Pepper, Hamilton & Sheetz, Philadelphia, as special counsel in connection with the investigation.

On October 15, 1979, Price Waterhouse delivered copies of its report entitled "Report of Independent Accountants on Investigation of Related Party Transactions and Perquisites" to the Official

Creditors' Committees, the Bankruptcy Court and the Company. (See Report on Form 8-K dated November 8, 1979, with respect to events occurring on October 15, 1979, together with the copy of the 620-page Price Waterhouse report attached thereto as an exhibit, which is hereby incorporated herein by reference). In addition, copies of the report were delivered to the Securities and Exchange Commission and a Federal grand jury sitting in the Eastern District of Pennsylvania pursuant to subpoenas previously issued to Price Waterhouse.

The report states that as a result of an initial search phase, Price Waterhouse proceeded to investigate a total of 115 transactions or relationships where there appeared to have been dealings between the Company and related parties. These investigations resulted in further reducing the number of identified related party transactions or relationships to 55, each of which is separately described in the report. Many of the transactions or relationships described involved members of the family of Samuel Friedland, the founder of the Company, their relatives or entities controlled by them. The report advises that notwithstanding the disclosures made therein, it does not set forth and Price Waterhouse has "specifically not formed any conclusions with respect to the legality or propriety of the conduct of any person or entity."

On November 1, 1979, the Board of Directors authorized the Audit Committee, composed entirely of non-management directors, to undertake an evaluation of the report and to determine what disposition the registrant should make of all matters involving related parties, perquisites and litigation concerning former management. The Audit Committee has evaluated the report and, with the advice of counsel, is currently considering appropriate action.

In January, 1979, the Securities and Exchange Commission issued an Order of Investigation for the purpose of examining various transactions between the Company and related or affiliated parties, and to examine the adequacy of the Company's financial reports and disclosures for a period of years prior to the filing of the Chapter XI Petition. On December 17, 1979, the Company was served with a subpoena from a Federal grand jury sitting in the Eastern District of Pennsylvania requesting internal audit documents. The Company does not know what action, if any, may be taken by either the Securities and Exchange Commission or the grand jury. (See "Legal Proceedings" with respect to litigation against related parties and Notes 5 and 6 of notes to consolidated financial statements.)

PACA License—Possible Suspension

Food Fair's operations require it and certain subsidiaries to be licensed under the Perishable Agricultural Commodities Act ("PACA"), administered by the U.S. Department of Agriculture. In November, 1979, the Department advised the Company that it is investigating whether violation of PACA were committed by Food Fair as a result of nonpayment of obligations to certain produce suppliers for goods sold and delivered. In accordance with the policy of the Department, no action has been taken to terminate the present license, but representatives of the Department have indicated that such action would be taken following the termination of the Chapter XI proceedings. Under Section 4(e) of PACA the issuance of a new license may be refused unless a bond "or other assurance satisfactory to the Secretary of Agriculture" is provided to the Department of Agriculture. In addition, under Section 8 of the PACA the Secretary of Agriculture may, among other remedies, suspend or revoke a license held by any entity which has been engaged in violations of the Act. The Company is negotiating with the Department of Agriculture for a settlement which would allow it to continue as a business licensed under the PACA after conclusion of the Chapter XI Proceedings, but is unable to predict with certainty if such license (which is indispensable to its business) can be obtained, or obtained on terms within its financial resources.

DELISTING OF SECURITIES

As a result of the Company's filing a petition under Chapter XI, its common stock was delisted on the New York Stock Exchange and suspended from trading on the Philadelphia and Pacific Stock Exchanges, and its 4% Subordinated Debentures and 8⅜% Sinking Fund Debentures were delisted from the New York Stock Exchange and the 4% Subordinated Debentures suspended from trading on the Philadelphia Stock Exchange.

Item 2. *Summary of Consolidated Operations*

The following summary of consolidated operations of the Company and its consolidated subsidiaries is not covered by the accountants' report. For the year ended July 28, 1979 the independent certified public accountants' report, which is included elsewhere herein, denies an opinion on the consolidated financial statements. The summary should be read in conjunction with the consolidated financial statements and related notes. (Numbered notes are included in the notes to consolidated financial statements for the years ended July 28, 1979 and July 29, 1978.)

	Year (52 weeks) ended				
		Restated			
	July 28, 1979	July 29, 1978	July 30, 1977	July 31, 1976	August 2 1975
	(In thousands except per share amounts)				
Sales	$1,487,270	$2,414,665	$2,145,125	$2,193,528	$2,175,218
Gross profit	247,439	436,023	410,896	405,043	392,729
Expenses and other income, net	321,684	440,445	381,731	373,686	363,954
Interest expense, net	16,506	39,065	14,908	14,964	17,686
Income (loss) before unusual items and income taxes	(90,751)	(43,487)	14,257	16,393	11,089
Unusual items (Notes b, c, 2 and 3)	(55,787)				
Income tax benefit (expenses)		8,776	757	(3,284)	4,036
Income (loss) from continuing operations	(146,538)	(34,711)	15,014	13,109	15,125
Loss from discontinued operations (Notes c, 3 and 11)	(58,978)	(19,840)	(11,768)	(9,281)	(18,559)
Cumulative effect of accounting changes (Notes d, e and 7)	(5,563)	(37,672)	4,175		
Net income (loss)	$ (211,079)	$ (92,223)	$ 7,421	$ 3,828	$ (3,434)
Net income (loss) per share of common stock (Note g)					
Continuing operations	$ (19.92)	$ (4.72)	$ 2.03	$ 1.77	$ 2.03
Discontinued operations	(8.02)	(2.70)	(1.60)	(1.26)	(2.51)
Cumulative effect of accounting changes	(.76)	(5.12)	.57		
	$ (28.70)	$ (12.54)	$ 1.00	$ .51	$ (.48)
Pro-forma amount assuming accounting changes applied retroactively:					
Continuing operations	$ (146,538)	$ (35,295)	$ 14,736		
Discontinued operations	(58,978)	(19,840)	(11,768)		
Cumulative effect of accounting changes			(2,338)		
Net income (loss)	$ (205,516)	$ (55,135)	$ 630		
Per share of common stock:					
Continuing operations	$ (19.92)	$ (4.81)	$ 2.00		
Discontinued operations	(8.02)	(2.70)	(1.60)		
Cumulative effect of accounting changes			(.32)		
Net income (loss)	$ (27.94)	$ (7.51)	$ .08		
Weighted average of common shares outstanding during the year	7,358	7,358	7,364	7,361	7,380
Cash dividends per share:					
Common		$ .20	$ .20	$ .20	$ .20
Preferred	$ 1.05	$ 4.20	$ 4.20	$ 4.20	$ 4.20

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

NOTES TO SUMMARY OF CONSOLIDATED OPERATIONS

(Not Covered by accountants' report)

(a) The Chapter XI Proceedings and related subsequent events and the basis of preparation of the Company's financial statements are more fully described in Note 1 of notes to consolidated financial statements.

(b) As stated in Note 2 of notes to consolidated financial statements, the 1979 Summary of Operations contains certain charges to operations which appear as if they do or may pertain in part to operation of prior years.

(c) In 1979, the Company discontinued its J. M. Fields discount department store operations and closed approximately 50% of its supermarkets, all of its meat processing and certain of its produce operations. (See Note 3 of notes to consolidated financial statements).

(d) Effective in August 1978, the Company changed its method of accounting for leases to comply with the provisions of "Statement of Financial Accounting Standards No. 13". Years ending prior to July, 1978 have not been restated retroactively due to incomplete information with respect to leases for those years.

(e) In the fourth quarter of 1977, the Company changed its methods of accounting as follows: (1) inclusion of warehousing costs in the determination of supermarket inventories; (2) the amortization of payroll tax expense over the entire year; and (3) the computation of deferred income taxes on the gross change method. In the fourth quarter of 1979, the Company again changed its accounting methods by excluding warehousing costs in the determination of supermarket inventories and by discontinuing the amortization of payroll tax expense over the entire year.

(f) During the fifty-two weeks ended July 30, 1977, the Company acquired the net assets of 17 supermarkets and the capital stock of a company which operated 43 supermarkets. Both acquisitions were accounted for as purchases; therefore, operations of the acquired supermarkets are included in the Consolidated Summary of Operations from the date of purchase. Pro-forma combined sales of the Company and the acquired businesses for 1977 approximate $2,600,000,000.

(g) Income (loss) per share of common stock is stated after preferred stock dividends and is based on the weighted average number of shares outstanding during each year. The average number of shares outstanding has not been adjusted to include stock options, warrants, and convertible subordinated notes because their inclusion in the calculation would be anti-dilutive.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF
SUMMARY OF CONSOLIDATED OPERATIONS

Due to the circumstances necessitating the filing of Chapter XI petitions on October 2, 1978, management's discussion and analysis of the foregoing Summary of Consolidated Operations should be read in conjunction with Item 1. "Business", and Item 12(a) "Financial Statements and Schedules" contained elsewhere in this report.

1979 Compared to 1978

Management believes that comparisons between 1979 and 1978 results of operations are not meaningful on account of the Company's filing of petitions under Chapter XI of the Bankruptcy Act on October 2, 1978, and various actions taken by it as a result thereof or in connection therewith. During this period and pursuant to a strategy of continuing to operate only in those areas, both business and geographic, where it had been historically profitable, the Company terminated its supermarket operations in the Pennsylvania, New Jersey, New York, Connecticut, and Tampa, Florida areas; discontinued its J. M. Fields discount department store operations; and closed its meat processing and certain produce operations. The Company is in the process of disposing of its interest in properties related to those operations and in any other properties and assets not essential to its ongoing business. Proceeds from the dispositions will be primarily applied to the Company's obligations under the proposed Plan of Arrangement and used to fund a portion of the Company's Capital Improvements Program and pay certain secured indebtedness.

As of July 28, 1979 the continuing operations of the Company consisted principally of 220 supermarkets located in Florida, Maryland and other southeastern states. The Company also operates various food manufacturing and processing facilities of which the Company is the major customer. Other continuing operations consist of a footwear distribution operation and a legal reserve life insurance carrier. Sales of continuing operations comprise the sales for the year ended July 28, 1979 except the life insurance operations which are stated at the Company's equity in net assets.

As a result of the filing of the aforementioned Chapter XI petitions, interest expense ceased to accrue with respect to certain indebtedness.

Unusual items consist of disposal of properties and termination expenses, including net loss from closed supermarket operations after February 10, 1979 of approximately $36,000,000, adjustment for self-insurance, a significant portion of which applies to prior years, of approximately $15,000,000 and bankruptcy administration costs, less interest income on restricted cash, of approximately $6,000,000. The self-insurance provision is presented as an unusual item because an adjustment is required for claims incurred in prior years, and present management believes that reasonable estimates could have been made for such claims in the years in which they were incurred and appropriate claims reserves recorded.

In 1979, the Company changed certain methods of accounting in order to be consistent with industry practices by excluding warehouse costs in the determination of supermarket inventories and discontinuing the amortization of payroll taxes. In 1979, the Company retroactively changed its method of accounting for leases to comply with the provisions of Statement of Financial Accounting Standards No. 13.

The net loss increased to approximately $211,000,000 due principally to the loss from J. M. Fields of approximately $59,000,000, continuing supermarket operations (including loss from closed supermarkets and related operations) of approximately $64,000,000, the unusual items referred to above of approximately $56,000,000 and the provision for creditors claims included in expenses and other income of approximately $24,000,000.

See "Qualification" on Cover Page

1978 Compared to 1977

Sales increased 12.6% or $269,500,000 in the year ended July 29, 1978. The increase in sales was due to new store openings, the effect of a full year's sales from the Penn Fruit and Hills stores acquired in 1977 and the absence of a strike which adversely affected 1977 sales. Store closings partially reduced the increases enumerated above.

Operating and administrative expenses increased 15.4% or $58,700,000 for the year ended July 29, 1978, due principally to increases in wages, occupancy, and supermarket and warehouse overhead expense.

Interest expense increased by approximately $24,000,000 in 1978 principally as a result of amounts representing interest on capitalized leases (see Note 11 of notes to consolidated financial statements) and an increase in the prime rate which was the basis for computing interest under many of the Company's loan agreements, the effect of the $50,000,000 revolving credit agreement being outstanding during all of 1978 and only partially in 1977.

The increase in tax benefits of approximately $8,000,000 is primarily due to the utilization of the net operating loss incurred in 1978.

Income from operations decreased approximately $100,000,000 in 1978 due principally to heavy competitive pressures resulting in lower profit margins, particularly in the J. M. Fields operations, newly negotiated labor agreements substantially increasing payroll and fringe benefits, various accounting adjustments relating to the realizability of certain Company assets, a charge to operating and administrative expenses, representing the unreconciled excess of receivables over payables among the Company and consolidated subsidiaries at July 29, 1978, and the full year effect of operating and administrative expenses with respect to fiscal 1977 supermarket acquisitions. The adverse effect of these conditions may have been aggravated by serious deficiencies in the system of internal accounting controls. In addition, the cumulative effect of accounting for leases accounted for approximately $38,000,000 of the loss.

Item 3. ***Properties***

Pursuant to the Company's decision to relocate its executive offices closer to its principal continuing operations, the Company transferred its executive offices to facilities located at 6500 North Andrews Avenue, Fort Lauderdale, Florida 33309, effective December 3, 1979. The new office facilities are subject to a lease dated July 20, 1979, having an initial term of 6 years. The lease covers approximately 35,000 square feet of office space and provides for four 6 year renewal options.

As of April 25, 1980, the Company leased 165 of its ongoing supermarkets under agreements with third parties, which provided, in typical cases, for the construction of the retail facility by the landlord to the Company's specifications, and for a subsequent lease thereof to the Company for periods of fifteen years or more (with renewal options) at negotiated rentals. Lease agreements provided in many cases for the payment by the Company of all or a portion of certain expenses, such as taxes and maintenance costs, and the payment of additional rentals based upon a percentage of sales from the premises.

The balance of the Company's ongoing supermarkets were constructed by the Company (sometimes as part of a "strip" shopping center) and, as to a total of 38 the Company owned the fee interest, with the remaining one being occupied under a net lease arising pursuant to a sale-leaseback transaction.

As indicated in "Competition", the Company is subject to intense competition at all of its supermarket locations. Many of the Company's supermarkets compete with supermarkets that are newer or have been more recently modernized than the Company's stores, a factor which operates to the disadvantage of the Company. The Company will seek to modernize its older stores through the Capital Improvements Program approved by the Court in October, 1979, and may from time to time close stores which cannot be economically modernized. There can be no assurance, however, that the Company's financial condition will permit substantial expenditure for such modernizations.

The Company's soft drink bottling plant and several of its auxiliary warehouses are owned in fee. The remainder of the Company's warehouse space and food processing facilities are occupied under long-term leases with renewal options, and in some instances, purchase options.

The Company deems its current warehousing facilities adequate for its needs, with sufficient capacity to meet its reasonably foreseeable requirements. Frozen food warehousing requirements are provided through independent suppliers. Machinery and equipment at its food processing facilities are deemed adequate for present and reasonably foreseeable requirements.

Item 4. ***Parents and Subsidiaries.***

(a) Parents

Based upon the most recent information contained in filings by such persons with the Securities and Exchange Commission, Samuel Friedland was the beneficial owner of 1,249,387 shares (17%) of the Company's Common Stock. As to 114,965 (1.6%) of said shares, he held shared voting and dispositive power with his sons, Jack and Harold Friedland, and as to 800,000 of said shares (10.9%) owned by others, he was the sole voting trustee. Samuel Friedland may be deemed the indirect beneficial owner of an additional 247,063 shares of the Company's Common Stock (3.4%) held by Hasam Realty Corp. ("Hasam"). Hasam also holds the aforesaid 800,000 shares as pledgee. The Company has been advised that, as of January 31, 1980, Samuel Friedland (i) was the Chief Executive Officer of Hasam, and his sons, Jack and Harold Friedland, were officers of Hasam; (ii) owned directly 1.7% of Hasam's voting stock; (iii) held sole or shared voting and dispositive power as fiduciary as to an additional 28% of Hasam's voting stock; and (iv) held a vested remainder interest in a trust which held 49.6% of Hasam's voting stock, of which trust Harold and Jack Friedland are two of the three trustees and hold voting and dispositive power with respect to such shares. Harold and Jack Friedland have advised the Company that each also holds beneficially an additional .6% of Hasam's voting stock, and may also be deemed the indirect beneficial owners of Hasam's shares of Food Fair Common Stock. Jack Friedland individually has sole voting and dispositive power as to 73,988 shares (1%) of Food Fair Common Stock and shares voting and dispositive power with Harold Friedland as to 3,000 additional shares of Food Fair Common Stock.

Any determination as to whether Samuel Friedland presently is a "parent" of the Company has been affected by the following: (i) the resignations on November 14, 1978 of Samuel and Jack Friedland and Louis Stein from all positions with Food Fair, (ii) the current status of Food Fair as a debtor-in-possession under Chapter XI and its consequent supervision by the Court and the Official Creditors' Committees, and (iii) the appointment of Grant C. Gentry, who is unaffiliated with Samuel Friedland, as Chairman of the Board, President and Chief Executive Officer of the Company, and the appointments of other unaffiliated senior executive officers and directors. The proposed Plan of Arrangement provides for the issuance of a substantial number of shares of preferred and common stock having full voting rights. This action would result in a significant reduction in the percentage of Company voting shares held by members of the Friedland family to less than 10% of the total, but increasing as such preferred stock is retired under the terms of the Plan. (See "Proposed Plan of Arrangement.")

(b) Subsidiaries

Each of the corporations named below is a subsidiary of Food Fair. All such subsidiaries are consolidated with Food Fair for financial reporting purposes, except its wholly-owned life insurance company.

Parent	State of Incorporation
Food Fair, Inc.	Pennsylvania
Name of Subsidiary (Wholly-Owned)	
Realmart, Inc.	Delaware
Newcorp Supermarkets, Inc.	Pennsylvania
Tulip Parking Corporation	Pennsylvania
J. M. Fields, Inc.	Florida
Fixtures and Equipment Leasing Co., Inc.	New Jersey
Ideal Shoe Company	Pennsylvania
Maryland Milk Company	Maryland
Sel-Lect Kent Corporation	Pennsylvania
Sunshine Milk Company, Inc.	Florida
Mark Distribution Corporation	Florida
Washington Square Life Insurance Co.*	Pennsylvania
Herco, Inc.	Delaware
Greys Poultry, Ltd.	Bahama Islands
Twin Packing Co. of Florida	Florida
Golden Banana, Inc.	Florida
El Dorado Sales, Inc.	Arizona
Idealco, Inc.	New York
Supermarket Display Corp.	Delaware
B.I.P. Services, Inc.	Pennsylvania
Footwear Services, Inc.	New Jersey
Hills Supermarkets, Inc.	Delaware
Trojan Transportation, Inc.	Pennsylvania
F.F. Financial Corporation	Nevada
Food Fair Anne Arundel, Inc.	Maryland
Food Fair West Baltimore, Inc.	Maryland
Pantry Pride #3 Salisbury, Inc.	Maryland
F F Realty, Inc.	Delaware

* Financial statements not consolidated

Monarch Investment Co., Ltd., an 80% owned subsidiary, incorporated in Bahama Islands, is consolidated in the financial statements.

The names of certain other subsidiaries (including those in which the Registrant owns 50% of issued and outstanding common stock) have been omitted because, considered in the aggregate as a single subsidiary, they would not constitute a significant subsidiary.

Item 5. *Legal Proceedings*

The Company and nine of its subsidiaries are presently and have been since October 2, 1978, operating as debtors in possession under Chapter XI of the Bankruptcy Act, under the supervision of the Court. As a result of the filing by these corporations of petitions for arrangement under Chapter XI, or as the result of non-payment of various obligations, or both, the Company and various of its subsidiaries are or may be in default under numerous loan agreements, indentures, promissory notes, guarantees, leases of real and personal property, security agreements, mortgages, and other contractual

See "Qualification" on Cover Page

arrangements, including arrangements with labor unions relating to health and welfare contributions, severance pay and pension contributions. The filing of the Chapter XI petitions gave rise to an automatic stay, under Bankruptcy Rule 11-44, of all actions against the filing entities, whether arising out of the foregoing matters or otherwise.

Liabilities, if any, of the Company arising from the litigation described below could survive termination of the Chapter XI Proceedings and not be affected by the Plan of Arrangement.

Many of the substantive allegations of the lawsuits described in (a) through (h) below were also the subject of an investigation conducted by Price Waterhouse & Co. on behalf of the Official Creditors' Committees, and may be the subject of investigations conducted by the Securities and Exchange Commission and by a Federal grand jury sitting in the Eastern District of Pennsylvania. (See Item 1.)

(a) The Company is a nominal defendant in an action, purportedly a shareholders' derivative action, filed on August 30, 1978, entitled *Harry Lewis v. Filigree Foods, Inc., et al* (United States District Court for the Eastern District of Pennsylvania). In general, the complaint alleges impropriety in dealings between the Company and Filigree Foods, Inc. (a food distributor which supplied certain of the Company's stores and in which Hasam Realty (see Item 4) and Samuel Stein (brother of former Chairman of the Board, Louis Stein) were significant stockholders); impropriety in dealings among the Company, J. M. Fields, Inc. and Richman Associates (a food brokerage firm of which Harold Friedland is the principal stockholder) and alleges damage to Food Fair as a result of its dealings with Filigree and Richman. The complaint further alleges that MGS Incentives Company, a former subsidiary of the Company, was sold by Food Fair to Harold Friedland in 1976 for a "grossly inadequate consideration" and that subsequent dealings between MGS and the Company were improper and caused further damage to Food Fair. The complaint concludes that "the acquisition of Filigree, Richman and MGS by the Friedland interests . . . improperly deprived Food Fair of advantageous corporate opportunities, properly belonging to the corporation . . . and unjustly enriched" certain defendants.

(b) The Company is a nominal defendant in an action, purportedly a shareholders' derivative action, filed on September 1, 1978, entitled *Alton E. Gross v. Harold Friedland, et al* (United States District Court for the Southern District of New York). The allegations in *Gross* are substantially the same as the allegations in *Lewis,* i.e. that the Company's dealings with Filigree Foods, Inc. and Richman Associates were disadvantageous to Food Fair.

(c) The Company is a defendant in an action, purportedly brought as a class action on behalf of the holders of the Company's 4% Subordinated Debentures due April 1, 1979, filed on or about October 13, 1978, entitled *Eleanor Bader and Irving Bader v. Food Fair, Inc., et al* (United States District Court for the Southern District of New York). The complaint alleges a series of misleading optimistic shareholder communications during the period 1974 through October 3, 1978. The complaint states that the Company's annual reports and other communications failed to indicate numerous adverse developments concerning the Company's business, including the "strong emergence of competitors," the "numerous self-dealings and conflicts of interest of the Friedland family," the Company's "declining position in the market place," its "continuing labor unrest," and its emerging liquidity problems and the understocked conditions of its supermarkets.

(d) The Company is a defendant in an action, purportedly brought as a class action on behalf of the holders of common stock, filed on or about November 1, 1978, entitled *Mary M. Stein, Custodian v. Jack M. Friedland, et al* (United States District Court for the Eastern District of Pennsylvania). The allegations concerning false stockholder reports and financial statements are similar to those contained in the *Bader* case. (See (c) above.) Among other matters, the plaintiff alleges the following material omissions from the Company's stockholder reports and financial statements: the existence of "massive backlogs in Food Fair's bookkeeping department," serious problems in making payments to suppliers; inability to obtain credit from suppliers; and shortages at the stores and a consequent substantial reduction in sales and a declining cash flow. The plaintiff also cites a loss of confidence by suppliers in the Company because "Food Fair's brokers and wholesalers were close friends or relatives" of management.

An allegation is also made that the Company's press releases accompanying the receipt of a $28 million loan in August, 1978, were misleading, in that such releases referred to the use of proceeds of such loan for "working capital" which plaintiff alleges is inconsistent with the alleged use of the proceeds for "payment of substantial creditors on delinquent or delayed accounts payable."

The Stein complaint also makes allegations concerning dealings between the Company, Filigree Foods, Inc. and Richman Associates and further alleges dealings with Vendor Distributors, Inc., a specialty food distributor run by Jay Lerner, brother of Marvin Lerner, then a vice president of the Company; Wiltshire Brokerage Co., a food brokerage run by Edward Bellet, son-in-law of Louis Stein, formerly Chairman of the Board of the Company; and Service Corp. of Florida, which allegedly is run by William B. Cohen, described as a "close personal friend" of Harold Friedland.

(e) The Company is a defendant in an action, purportedly brought as a class action, filed on November 19, 1978, entitled *William Elster v. Samuel Friedland, et al.* (United States District Court for the Southern District of New York). This action is brought on behalf of a class consisting of "all persons who purchased securities of Food Fair, Inc. . . . during the period commencing October 5, 1975, and ending October 2, 1978." The plaintiff claims ownership of $20,000 of Food Fair's 4% Subordinated Debentures due April 1, 1979. The complaint alleges non-disclosure as to the following matters: self-dealing by the Friedland and Stein families; the purchase by Food Fair of merchandise from sources controlled by the Friedland and Stein families at prices higher than would have been paid to independent suppliers; inadequate bookkeeping; disadvantage to Food Fair in dealing in the food trade because of its reputation of dealing with insiders; and further alleges non-disclosure of the fact that Food Fair's grocery stores were largely small stores operating in geographic areas where the population growth was static or declining and where the income levels were static or declining. Damages are alleged resulting from purchases of securities during the period October 5, 1975 through October 2, 1978.

(f) The Company is a defendant in an action, purportedly brought as a class action on behalf of the holders of Food Fair common stock, filed on or about December 29, 1978, entitled *Steven Goldman v. Jack M. Friedland, et al.* (United States District Court for the Eastern District of Pennsylvania). The period of damages alleged is limited to April 1, 1978 through October 2, 1978. The substantive allegations of the complaint are the same as in the Stein complaint referred to in (d) above.

All of the cases described in paragraphs (a) through (f) above have been consolidated for pretrial purposes in the Eastern District of Pennsylvania. In the class actions discussed in paragraphs (c) through (f), the Company filed, on September 28, 1979, an answer and cross-claim (i) denying any liability on its part and stating that it has no knowledge with respect to the liability of the other defendants, (ii) asserting several affirmative defenses, and (iii) asserting in the cross-claim, among other allegations, that if the allegations contained in those lawsuits are found to be true and the Company is held liable, then certain other persons should in turn be held liable to it. Counsel for the various parties have discussed the possibility of settlement of these cases. That general discussion, which is continuing, has not resulted in any agreement on terms for disposition of the litigation.

(g) An action entitled *Morris Ray v. Food Fair, Inc. et al* has been commenced by way of adversary proceeding in the Bankruptcy Court seeking to lift the automatic stay so as to permit commencement of a purported derivative action generally alleging damages to the Company arising out of alleged related party transactions.

(h) On November 21, 1978, a stockholder of Amterre Development Inc ("Amterre") filed a suit against Food Fair, Amterre, and Amterre's directors, in which it is alleged that Amterre was injured because of various sale and lease transactions with Food Fair. This suit, entitled *David Harrow v. Food Fair, Inc., et al.* has been transferred from the United States District Court for the Southern District of New York to the United States District Court for the Eastern District of Pennsylvania. The present complaint alleges that Amterre breached its duty to the common stockholders of Amterre by failing to pay common stock dividends while periodically paying dividends on the 6% Preferred Stock owned by Food Fair and alleges that various breaches of fiduciary duty and acts of corporate mismanagement were not disclosed in Amterre proxy statements and in other public filings. An injunction is being sought as to the publicly announced proposed liquidation of Amterre on the grounds that such liquidation will be solely to the benefit of Food Fair, and that Amterre public stockholders will receive nothing in the liquidation. The trial court denied the plaintiff's motion for a preliminary injunction prior to the Amterre stockholders meeting on March 21, 1980, where the plan of liquidation was approved. The Company has been advised that management of Amterre intends to proceed with the liquidation of Amterre, in the absence of a contrary order of the Court.

Recovery by plaintiffs in the lawsuits described in (c), (d), (e), (f), (g) and (h) above could result in the imposition of liability upon the Company in amounts presently not determinable (but which could be substantial), subject to a possible right on the Company's part to recover against one or more of the other defendants or third parties.

(i) On December 20, 1978, the New York Department of Taxation and Finance issued a "Notice of Determination and Demand For Payment of Sales and Use Taxes Due" (the "Food Fair Notice") to the Company for the period beginning with the quarter ended February 28, 1973 through and including the quarter ended August 31, 1977. The Food Fair Notice assesses a deficiency of $3,626,512 in New York sales and use tax for the period, plus interest in the amount of $1,692,919.

On December 28, 1978, the New York Department of Taxation and Finance issued a similar notice to J. M. Fields, Inc. ("Fields"), a wholly owned subsidiary of the Company, (the "Fields Notice") for the period beginning with the quarter ended February 28, 1973 through and including the quarter ended February 28, 1978. The Fields Notice assesses a deficiency of $874,006 in New York sales and use tax for this period, plus interest in the amount of $258,623.

On April 21, 1980 the Company reached a preliminary settlement subject to court approval with the New York Department of Taxation and Finance pursuant to which the Company would pay an aggregate of approximately $3,011,000 in full settlement of the Food Fair and Fields Notices.

(j) The Company, together with numerous other retail food companies and others, has been named as a defendant in multiple civil actions brought in various United States District Courts by certain cattle producers and feeders alleging violations of the antitrust laws in connection with the purchase and resale of beef. The cases, most of which have been or are anticipated to be consolidated for pretrial purposes in the United States District Court for the Northern District of Texas, seek damages in an unspecified amount and an injunction against further antitrust violations as alleged. Reference is made to Item 3 of the Company's reports on Form 8-K for January, 1976 and August, 1976, for a description of these cases. Management believes that no basis exists for the allegation made against the Company and, after consultation with counsel, is of the opinion that these actions will not have a material adverse effect on the financial condition of the Company. In October, 1977, the United States District Court in Texas dismissed the cases consolidated before it upon the ground that under a recent decision of the United States Supreme Court the plaintiffs lacked standing to sue on the basis that indirect sellers have no standing to sue indirect purchasers under the federal antitrust statutes. The Court's decision does not directly apply to cases not consolidated before it. The dismissal was reversed in August, 1979 by the Fifth Circuit Court of Appeals, which held the Supreme Court decision to be inapplicable to the particular allegations of the plaintiffs' case. A motion by defendants for a rehearing has been denied and the defendants presently intend to petition the Supreme Court for certiorari. The Fifth Circuit's opinion does not address, and does not dispose of, the merits of these cases.

(k) The Company is also a defendant in a case entitled *Boccardo v. Safeway Stores, Inc.* pending in the California Superior Court, San Francisco County. This case which seeks unspecified actual damages and unspecified punitive damages for an alleged conspiracy by supermarket chains, including the Company, to depress the prices paid for beef, is brought under the California anti-trust laws. The case was previously dismissed by the court and such dismissal is being appealed by the plaintiffs to the California Court of Appeals.

(l) Reference is made to Item 3 of the report of the Company on Form 8-K for August, 1976, for a description of *First National Professional Corporation* ("FNPC") *v. Beneficial National Life Insurance Company of New York, et al.* The Company has filed an answer denying the material allegations of the complaint, and to date only limited discovery has been taken. The claim was stayed by the filing of the Chapter XI petitions. FNPC then filed the claim in the Bankruptcy Court. The Company has objected to the claim, filed in the Chapter XI Proceedings by FNPC and expects to try the issue in the Bankruptcy Court.

(m) Reference is made to Item 5 of the Company's reports on Form 10-K for the years ended July 31, 1976, and July 30, 1977, for a description of *Stonewall Insurance Company v. Food Fair Stores, Inc., et al.* As of July 29, 1978, the amount of the claims matured and unpaid by Stonewall to Food Fair aggregated approximately $8,445,000.

Although extensive discovery has been taken in the *Stonewall* case, substantial additional discovery remains to be taken. Counsel to the Company have advised that upon the basis of the completed discovery, plaintiff has not to date come forward with evidence sufficient to sustain its claim for recission. Nevertheless, in view of the substantial factual discovery remaining to be taken, the Company is not in a position to predict the outcome of this case.

(n) Reference is made to the Company's report on Form 10-Q for the period ending May 7, 1977, and Item 5 of its report on Form 10-K for the year ended July 30, 1977, for a description of *Auerbach v. Eberle.* In March, 1980, with Court approval, a settlement was reached under which Food Fair paid approximately $50,000.

Item 6. ***Increases and Decreases in Outstanding Securities and Indebtedness***

a. There was no increase or decrease during the period indicated in the amount of equity securities of the Company outstanding except as indicated below:

Preferred Stock

Outstanding at July 29, 1978	16,265 shares
Deduct: Shares redeemed for sinking fund purposes	75 shares
Outstanding at July 28, 1979	16,190 shares

In transactions during the 1979 fiscal year prior to October 2, 1978, the Company acquired by purchase in the open market 75 shares of the $4.20 Dividend Cumulative Preferred Stock. The statement of Designation and Relative Rights and Preferences of the $4.20 Dividend Cumulative Preferred Stock, Series of 1951, $15 par value, requires the Company to set aside in a sinking fund, semi-annually, the sum of $120,000 less the sum of $100 for each share of such Preferred Stock which the Company may purchase or redeem and credit against such sinking fund requirements. The foregoing obligation has been stayed during the pendency of the Chapter XI proceedings.

b. Pursuant to a revolving credit agreement dated July 28, 1978, entered into by the Company with a group of banks, the Company borrowed $28,000,000 in August 1978. The funds borrowed bore interest at ½% (2½% upon default) above the prime rate. Under the agreement the Company pledged, among other things, certain land and buildings which cost approximately $15,000,000, its investment in and advances to Amterre, certain notes receivable and the right to receive sublease income from certain properties in northern New Jersey. On May 25, 1979, the Company paid, without prejudice and with the approval of the Bankruptcy Court, the $28,000,000 loan together with $2,400,000 of accrued interest thereon.

Pursuant to an agreement dated as of July 27, 1973, as amended on July 25, 1977, a bank advanced to the Company up to $15,000,000 in exchange for certain accounts receivable of the Company and certain of its subsidiaries. The funds advanced bear interest at 2% above the prime rate. On October 29, 1979, the Company paid, without prejudice and with the approval of the Bankruptcy Court, $11,653,294 of the principal amount outstanding.

Item 7. ***Changes in Security and Changes in Security for Registered Securities***

The Company cannot pay dividends during the pendency of the Chapter XI Proceedings, and the proposed Plan of Arrangement with unsecured creditors would substantially restrict the payment of dividends during the lengthy period that payments to such creditors will be required under the Plan. (See "Proposed Plan of Arrangement")

Item 8. ***Defaults Upon Senior Securities***

As a result of the commencement of the Chapter XI proceedings the Company is in default with respect to the following indebtedness:

Mortgages and notes payable, secured	$ 6,060,000
Notes payable, banks	55,288,000
Notes payable, other	6,123,000
Subordinated debentures, 4%	10,350,000
Subordinated debentures, 8.5%	17,000,000
Sinking fund debentures, 8.375%	31,309,000
	$126,130,000

Also, at May 3, 1980, there were six quarters of dividend arrearages on the Company's outstanding redeemable preferred stock which totalled $102,000.

The Company's proposed Plan of Arrangement provides for significant changes in the debt instruments and outstanding preferred stock and terms of payments. ("Proposed Plan of Arrangement")

Item 9. ***Approximate Number of Equity Security Holders***

Set forth below is the approximate number of holders of record of each class of equity security of the Company outstanding at February 29, 1980.

Title of Class	Number of Record Holders
$4.20 Dividend Cumulative Preferred Stock, Series of 1951, $15 par value	48
Common Stock, $1 par value	12,292

Item 10. ***Submission of Matters to a Vote of Security Holders***

Not applicable.

Item 11. ***Indemnification of Directors and Officers***

Section 1410 of the Pennsylvania Corporation Law (15 Purdon's Pennsylvania Statutes Annotated Sec. 1410) provides in general that a business corporation may indemnify its officers and directors, who are parties to litigation by reason of their position, against expenses (including attorneys' fees), judgments, fines and settlement amounts incurred in connection therewith if such persons acted in good faith. The statute also provides that a business corporation may indemnify its officers and directors for expenses (including attorneys' fees) incurred in defending or settling litigation brought against such persons by or in the right of the corporation if such person acted in good faith, except that no indemnification is permitted (with limited exceptions) where such persons have been adjudged liable for negligence or misconduct in the performance of their duties to the corporation. In any litigation of the nature discussed in the foregoing sentences, a corporation is required to indemnify an officer or director against expenses (including attorneys' fees) incurred by him if he is successful on the merits or otherwise in defense of such litigation. Indemnification payments to an officer or director authorized by the statute may be made only upon a determination made by: (i) the Board of Directors by a majority of disinterested directors, (ii) independent counsel or (iii) the shareholders, that indemnification is proper in the circumstances. Under certain circumstances, if approved in the manner set forth in the foregoing sentence, an officer or director may be advanced his expenses in defending an action if he undertakes to refund such advance unless it is ultimately determined that he is entitled to be indemnified. The provisions of this foregoing statute are not exclusive of other rights to which officers or directors seeking indemnification may be entitled under any by-law, agreement, vote of shareholders or disinterested directors.

On October 1, 1978, the Board of Directors adopted a resolution indemnifying officers and directors against expenses reasonably incurred in defending the case of *Lewis v. Filigree Foods, Inc. et al* (See Item 5, incorporated herein by reference, for a description of such litigation.) and a further resolution providing that such expenses, and expenses incurred in the defense of other litigation arising out of matters which are similar to the matters and causes alleged in this case, be paid to such officers and directors in advance, provided that the recipients execute undertakings to refund these advances unless it is ultimately determined that they are entitled to be indemnified. The effect of the Chapter XI Proceedings on the Company's obligations, if any, under this resolution, is unclear, as is the validity of the resolution itself, given the circumstances of its adoption.

On March 13, 1979, the Court approved the adoption by the Board of Directors on February 23, 1979, of a new By-Law provision, which generally accords to officers and directors the rights to indemnification which are authorized by the above described Section 1410 of the Pennsylvania Corporation Law. The By-Law does not authorize, however, indemnification with respect to matters relating to financial participation by officers or directors or members of their families in transactions involving conflicts of interest, usurpation of corporate opportunities or other breaches of fiduciary responsibilities to the Company. The Order of the Court provides that such resolution is effective as of October 2, 1978, provided, however, that it applies only to officers and directors as of February 23, 1979 or thereafter. This By-Law may supersede the aforesaid Board resolution of October 1, 1978.

Through April 25, 1980, the Company had made payments for legal fees totalling approximately $59,000 to attorneys, otherwise unaffiliated with the Company, who have represented several present or former employees that have been called upon to give information in connection with the various investigations into the Company's transactions with related or affiliated parties. No other indemnification payments or advances have been made by the Company to or on behalf of any present or former director or officer and no indemnification will be made without the approval of a majority of the disinterested members of the Board of Directors.

Item 12. *Financial Statements, Exhibits Filed, and Reports on Form 8-K*

(a) 1. Financial Statements

See index to the annexed financial statements.

2. Exhibits

A. Proposed Plan of Arrangement, incorporated herein by reference to Report on Form 8-K dated May 9, 1980.

B. Report of Independent Accountants on Investigation of Related Party Transactions and Perquisites, incorporated herein by reference to Report on Form 8-K dated November 8, 1979.

(b) Reports on Form 8-K filed during the last quarter of the fiscal year ended July 28, 1979.

1. On May 30, 1979, a Report on Form 8-K was filed relating to the change in independent auditors, which report was amended by a Form 8 Amendment dated June 14, 1979.
2. On May 9, 1979, a Report on Form 8-K was filed relating to the closing of the J. M. Fields discount department stores.

Item 13. *Security Ownership of Certain Beneficial Owners and Management*

The following table sets forth, as of March 14, 1980, information concerning the beneficial ownership of the Company's common stock by (1) each director; (2) all directors and officers as a group

See "Qualification" on Cover Page

(14 persons); and (3) each person who is known to the Company to be the beneficial owner of more than five percent of the Company's common stock:

	Amount and Nature of Beneficial Ownership					
Name of Beneficial Owner	Sole Voting Power	Sole Investment Power	Shared Voting Power	Shared Investment Power	Total Beneficial Ownership	Percent of Class
(a) *Directors*						
Joseph L. Castle	–0–	–0–	–0–	–0–	–0–	—
John M. Fox	–0–	–0–	–0–	–0–	–0–	—
George Friedland	292,208	292,208	19,028(1)	19,028(1)	311,236	4.2%
Roger L. Galassini ...	–0–	–0–	–0–	–0–	–0– (3)	—
Grant C. Gentry	–0–	–0–	–0–	–0–	–0– (2)	—
Frank N. James	1,311	1,311	–0–	–0–	1,311(3)	*
Jewel S. LaFontant ...	–0–	–0–	–0–	–0–	–0–	—
James J. Needham ...	1,000	1,000	–0–	–0–	1,000	*
James J. Wachter	–0–	–0–	–0–	–0–	–0– (3)	—
(b) *All Officers and Directors as a Group*	294,878	292,208	19,028	19,028	313,906	4.3%
(c) *Beneficial Owners of Over 5% of Class*						
Hasam Realty Corp. .. 8080 N.E. 5th Ave. Miami, Florida 33138	247,063(4)	247,063(4)	800,000(4)	800,000(4)	1,047,063(4)	14.2% (4)
Samuel Friedland .... Hollywood-By-The-Sea Hollywood, Florida	877,359(4)	77,359(4)	372,028(4)	1,172,028(4)	1,249,387(4)	17.0% (4)
Jack Friedland .... 1020 North Lane Gladwyne, PA 19035	73,988(4)	73,988(4)	405,028(4)	1,205,028(4)	1,279,016(4)	17.4% (4)
Harold Friedland .... 2 Bala Cynwyd Plaza Bala Cynwyd, PA 19004	–0– (4)	–0– (4)	250,063(4)	1,205,028(4)	1,205,028(4)	16.4% (4)

* Less than .01%

(1) Held by the George Friedland Foundation, of which George Friedland is a Trustee.

(2) Mr. Gentry was granted options to purchase 200,000 shares at $2.00 per share in connection with his employment; such shares would, upon exercise, constitute 2.7% of the outstanding common stock. (See Item 15(b)(i)(A) incorporated herein by reference.)

(3) On April 11, 1979, Messrs. James and Galassini were granted, subject to Court approval (which was issued on May 2, 1979), options to purchase 15,000 and 10,000 shares, respectively, at $4.44 per share. On March 14, 1980, Mr. Wachter was granted, subject to Court approval, an option to purchase 10,000 shares at $3.375 per share. (See Item 15(d)(2).)

(4) The Company has been informed that Hasam Realty Corp. ("Hasam"), Samuel Friedland, Jack Friedland and Harold Friedland beneficially own an aggregate of 1,356,375 shares or 18.4% of the total outstanding. Hasam is the direct owner of 247,063 shares and the pledge of 800,000 shares which were sold in April, 1979, to four shareholders of Hasam, including Jack and Harold Friedland who each purchased 200,000 shares. The beneficial ownership indicated for Jack and Harold Friedland include shares owned and held in pledge by Hasam. The 800,000 pledged shares are held in a voting trust of which Samuel Friedland is sole voting trustee. The beneficial ownership indicated for Samuel Friedland includes the aforesaid 247,063 (3.4%) shares held by Hasam. 800,000 shares (10.9%) held by him as voting trustee, and 114,965 shares (1.6%) held by Samuel Friedland Family Foundation. (See Item 4.)

See "Qualification" on Cover Page

Item 14. *Directors and Executive Officers of the Registrant*

GRANT C. GENTRY—Chairman of the Board, President and Chief Executive Officer
Age—55

Mr. Gentry was elected to his present position as Chairman of the Board, President, and Chief Executive Officer on January 4, 1979. From April 1, 1978 to January 4, 1979 he was a Partner and Management Consultant with Adamy, Foley & Gentry. From March 1, 1975 to November 11, 1977 he was President and Director of The Great Atlantic & Pacific Tea Company. From March 1, 1958 to March 1, 1975 he served in various positions at Jewel Companies, Inc., ultimately becoming Executive Vice President and Director. Mr. Gentry also serves as a director of Olson Farms, Inc. and Bormans, Inc.

JOSEPH L. CASTLE—Director
Age—47

Mr. Castle was elected a Director on May 15, 1979. He is the Principal of Joseph L. Castle Associates, a firm engaged in business financial consulting. He also serves as Trustee in the reorganization of the Reading Company and a director of Horn and Hardart Baking Company and Pennsylvania Reading Seashore Lines. He is also actively engaged in the oil and gas industry as a Managing Partner of twelve partnerships with various working interests in Pennsylvania, West Virginia, Ohio, Louisiana and Texas. Mr. Castle is a former partner in the investment services firm of Butcher & Sherrerd and has been a vice president of the Philadelphia National Bank.

JOHN M. FOX—Director
Age—67

Mr. Fox was elected a Director on November 28, 1979. He is the recently-retired Chairman and Chief Executive Officer of H. P. Hood, Inc. An agribusiness consultant, Mr. Fox is a member of the Board of Trustees of Eastern Gas and Fuel Associates and a director of International Business Machines Corporation, SCA Services, Inc., The Harvey Group, Inc. and Director Emeritus of The Boston Company. Mr. Fox is the former Chairman and Chief Executive Officer of United Fruit Company and also served as President of Minute Maid Corporation, a company he helped to found.

GEORGE FRIEDLAND—Director
Age—77

Mr. Friedland has been a Director since 1937, and has been a private investor during the past five years. He served as president of the Company from 1941-1953 and from that time as Vice Chairman until 1959. He also served as a director of Amterre Development Inc, until his resignation in December, 1979.

ROGER L. GALASSINI—Executive Vice President, Chief Administrative Officer, General Counsel and Director
Age—41

Mr. Galassini was elected Vice President—Administration, General Counsel and Director in February, 1979. On March 14, 1980, he was elected to the positions of Executive Vice President and Chief Administrative Officer. He was employed by The Great Atlantic and Pacific Tea Company from July, 1975 to February, 1979, as Vice President for Public Affairs, becoming Vice President Administrative Services in April, 1978. From March, 1969 to July, 1975, he was employed by Jewel Companies, Inc., as corporate counsel, becoming assistant General Counsel in December, 1972 and Secretary in October, 1974.

FRANK N. JAMES—Executive Vice President, Chief Operating Officer and Director
Age—55

Mr. James was elected as Executive Vice President on March 14, 1980, and as Chief Operating Officer of the Company in March, 1979. He has served as a Director of the Company since January, 1977. From June, 1978 to March, 1979, he was Vice President in charge of Administrative Services. He was President of the Company's Pantry Pride Supermarket Division from September, 1976 to June, 1978, becoming a corporate Vice President in September, 1976. From January, 1975 to May, 1976 he was President of Colonial Stores, Inc., a supermarket chain based in Atlanta, Georgia. Mr. James previously served as Vice President and Director of the Company from August, 1973 to January, 1975.

See "Qualification" on Cover Page

JEWEL S. LAFONTANT—Director
Age—57

Mrs. Lafontant was elected a Director on August 9, 1979. She is a partner of Lafontant, Wilkins & Butler, attorneys-at-law. She also serves as a director of Trans World Corporation, Bendix Corporation, Continental Illinois Corporation, Foote, Cone & Belding, Inc., Harte-Hanks Communications, Inc., and The Equitable Life Assurance Society. She is a former Deputy Solicitor General of the United States and has served as President of the National Council on Minority Business Enterprises, Chairman of the Advisory Board of the Civil Rights Commission and member of the Advisory Commission on International Education and Cultural Affairs.

JAMES J. NEEDHAM—Director
Age—53

Mr. Needham was elected a Director on March 20, 1979. He was a Distinguished Professor, Graduate Division of the College of Business Administration of St. John's University from 1977 to 1978. From 1972 to 1976, he served as Chairman and Chief Executive Officer of the New York Stock Exchange, Inc., and from 1962 to 1972 as a Commissioner of the Securities and Exchange Commission. Mr. Needham is also a director of Merrill Lynch Municipal Bond Fund, Inc., Merrill Lynch CMA Money Trust, Merrill Lynch CMA Asset Trust, Lexington Growth Fund, Inc., Lexington Research Fund, Inc., Lexington Income Fund, Inc., Lexington Tax Free Income Fund, Inc., The Lexington Money Market Trust, SCA Services, Inc., NVF Company, Sharon Steel Corporation, Caesars World, Inc., Caesars New Jersey, Inc., American Savings and Loan Association, Home Savings and Loan Association and Westdale Savings and Loan Association.

JAMES J. WACHTER—Senior Vice President, Chief Financial Officer and Director
Age—41

Mr. Wachter was elected to his positions as Senior Vice President, Chief Financial Officer and Director on March 14, 1980. He was employed by Central Resources Corporation from March, 1976 to March, 1980, first as Controller and then as Vice President—Finance. From April 1974 to March 1976, he served as Group Controller in the International Division of International Playtex, Inc.

JOHN T. GRIGSBY, JR.—Vice President and Treasurer
Age—40

Mr. Grigsby was elected to his position as Vice President on April 11, 1979. On November 1, 1979, he assumed the additional responsibility of Treasurer. Until March 14, 1980, he also served as Chief Financial Officer and a Director of the Company. From 1969 to April 10, 1979, Mr. Grigsby was a Certified Management Consultant with Touche Ross & Co. He was previously a project manager for Philip Morris, Inc.

LEONARD J. PASTERNAK—Vice President
Age—45

Mr. Pasternak was elected a corporate vice president November 1, 1979. He joined the Company in 1964 as executive vice president of its Ideal Shoe Company subsidiary, becoming its president in 1968 and president of the Footwear Services subsidiary in 1969.

DARRELL V. STIFFLER, JR.—Senior Vice President—Industrial Relations
Age—54

Mr. Stiffler was elected to his present position on March 14, 1980. From September, 1978 until that date, he had served as Vice President—Industrial Relations. Previously, he was Corporate Vice President—Industrial Administration and Vice President of Industrial Relations for The Great Atlantic and Pacific Tea Company, a company where he served for almost 30 years.

NEIL THALL—Vice President—Management Information Systems
Age—33

Mr. Thall was elected to his present position in April, 1979. From 1973 to April, 1979 he was a Management Consultant with Touche Ross & Co. Prior to joining Touche Ross, Mr. Thall was Manager of Product Support Systems for Burroughs Corp.

See "Qualification" on Cover Page

HOWARD F. GORDON—Secretary

Age—39

Mr. Gordon was elected Secretary in 1975. He has been Corporate Counsel since 1972, and was named Assistant General Counsel in March, 1979.

Item 15. ***Management Remuneration and Transactions***

(a) The table below sets forth information as to aggregate remuneration paid on an accrual basis by the Company during the fiscal year ended July 28, 1979 to each of its five most highly compensated executive officers or directors whose total remuneration exceeded $50,000, and as to all directors and officers as a group.

Name of individual or persons in group	Capacities in which served	Salaries, fees, commissions, and bonuses
Grant C. Gentry	Chairman of the Board, President and Chief Executive Officer	$ 274,167
Frank N. James	Vice President, Chief Operating Officer and Director	$ 103,674
Marvin N. Lerner	Vice President and Director (resigned in March, 1979)	$ 98,007
Gerald Nathanson	Vice President and Director (resigned as Director in August, 1979 and as Vice President in October, 1979)	$ 200,000
John R. Lilly	Vice President, Chief Financial Officer and Director (resigned in April, 1979)	$ 105,000
All directors and officers as a group (25)		$1,348,245

The remuneration set forth above excludes any value attributable to incidental personal benefits, including use of Company automobiles, which may have been derived by certain officers and directors. This exclusion results from the fact that the specific amount of these benefits cannot be determined without unreasonable effort or expense, and after reasonable inquiry, management is not aware of any instance where the aggregate amount of such personal benefits exceeded $10,000 for any officer or director. (With respect to personal benefits derived in prior years by prior management, see the Price Waterhouse & Co. report dated October 15, 1979, attached as an exhibit to the Report on Form 8-K dated November 8, 1979.)

(b) *Proposed Remuneration*

(i) *Employment Agreements*

(A) On January 4, 1979, the Company entered into an employment agreement ("Agreement") with Grant C. Gentry, pursuant to which Mr. Gentry is serving as President, Chairman of the Board and Chief Executive Officer of the Company.

Pursuant to the Agreement, Mr. Gentry will be paid compensation consisting of a salary of $350,000 per year for the five-year term of the Agreement. Mr. Gentry was also paid the sum of $100,000 upon execution of the Agreement. In the event of Mr. Gentry's death or disability while employed, payment of such base compensation will continue to be made to his present wife, and, under certain circumstances, may be accelerated. The Company is also obligated to pay to Mr. Gentry, beginning on the later of (i) January 2, 1984 or (ii) his retirement from full time employment with the Company, for the remainder of his life and, if his present wife survives him, thereafter to her for the remainder of her life, as deferred compensation, the annual sum of $54,881, provided that Mr. Gentry has not, on or before January 2, 1984, either been discharged for cause, as specified in the Agreement, or voluntarily resigned his employment with the Company. Under certain circumstances, payments of deferred compensation to Mr. Gentry's wife may be accelerated.

The Agreement further provides for the issuance to Mr. Gentry of non-transferable options to purchase from the Company, on or before January 2, 1984, an aggregate of 200,000 shares of the Company's common stock at a cash price of $2.00 per share. Mr. Gentry may require the Company to register the shares acquired pursuant to such option, and may include such shares in any registration statement otherwise filed by the Company.

See "Qualification" on Cover Page

Mr. Gentry is also entitled to participate in employee fringe benefits generally available to the Company's key employees.

In order to assure Mr. Gentry of the availability of funds to comply with the Company's obligation, the Company has established separate trust funds with respect to and to secure the Company's obligations to pay base and deferred compensation to Mr. Gentry. Under the trust agreement pertaining to Mr. Gentry's base compensation, the Company deposited $1,558,662 in trust; under the trust agreement relating to Mr. Gentry's deferred compensation, the Company deposited $589,725 in trust. The trust agreements provide that the sums held in trust shall be reduced (and the amount of such reductions returned to the Company) in amounts equal to payments made by the Company to Mr. Gentry pursuant to the Agreement.

In the event of termination of Mr. Gentry's employment as a result of the transfer of the Chapter XI Proceedings to Chapter X of the Bankruptcy Act, or the liquidation of the Company or its adjudication in bankruptcy, Mr. Gentry is entitled to receive the present value of the remaining unpaid balance of his base compensation and the principal of the trust securing his deferred compensation.

(B) Frank James is entitled to total deferred compensation equal to $15,000 for each year he is employed by the Company since January 1, 1977, plus interest and an amount equal to any pension benefits loss by not treating Mr. James' deferred compensation as part of his annual salary when computing his benefits under the Company's Salaried Employees Retirement Plan, payable in installments upon his retirement, or to his designee in the event of his death prior to retirement. In addition to any benefits that might accrue to him under the Salaried Employees Retirement Plan since January 1, 1977, the Company has agreed to pay Mr. James, upon his retirement at normal retirement age, the amount of $11,390 per annum during his lifetime, which amount is equivalent to the pension that Mr. James would have received under the Company's Salaried Employees Retirement Plan (but for his voluntary separation from service in January, 1975) upon retirement by reason of his service with the Company prior to January, 1975.

(C) Gerald Nathanson, who resigned as Vice President in October, 1979, was employed pursuant to a contract, the term of which commenced in January, 1977 and which was to expire at the end of the Corporation's 1982 fiscal year. The Company has obtained an order from the Court rejecting and disaffirming its contract with Mr. Nathanson. Mr. Nathanson has filed a claim in the Court for approximately $1,600,000 to which claim the Company intends to formally object.

(ii) *Salaried Employees Retirement Plan*

The Salaried Employees Retirement Plan (the "Retirement Plan") provides fixed retirement benefits for regular employees of the corporation. Based upon certain assumptions, including the continuation of the Retirement Plan without amendment, the following table shows the annual retirement benefits which would be payable to persons at various salary levels after specific years of service:

Basic Annual Pay Assumed Constant	Estimated Annual Retirement Benefits for Number of Years Future Credited Service		
	10 years	20 years	30 years
$ 50,000	$ 5,785	$11,565	$17,350
100,000	13,285	26,565	39,850
150,000	20,785	41,565	62,350
200,000	28,285	56,565	75,000*
250,000	35,785	71,565	75,000*
300,000	43,285	75,000*	75,000*
350,000	50,785	75,000*	75,000*
400,000	58,285	75,000*	75,000*

* Maximum benefit provided by the Retirement Plan.

The above figures are based upon the Retirement Plan, as amended, assuming the 1979 Social Security level remains constant. Contributions are made solely by the Company and are determined on a group basis and therefore, amounts relating to pension benefits have been omitted from the compensation table set forth at the beginning of Item 15. Under the Retirement Plan contributions are based upon a percentage of participants' base compensation, excluding any bonuses, overtime or other special forms of remuneration. The percentage of base compensation used is developed by an independent actuary, and as of July 1, 1979, was 3.3%. For the fiscal year ended July 29, 1978, with respect to which contributions were due in the 1979 fiscal year, the Company has obtained a waiver from the Internal Revenue Service on making any contributions to the Retirement Plan. Under the terms of this waiver, the Company will fund its obligations with respect to 1978 over the next 15 years.

(c) *Remuneration of Directors*

(1) Non-employee directors receive annual fees of $10,000 plus $500 for each Board or Board committee meeting attended.

(2) Until November, 1978 and March, 1979, respectively, Louis Stein and Herman Silver were parties to consulting arrangements with the Company whereby they received consulting fees in lieu of any director's fees or other compensation to which they may have been entitled. For financial consulting as well as his services as a director, Mr. Stein was compensated at an annual rate of $40,000. Mr. Silver was compensated at an annual rate of $30,000 for consulting services rendered by him regarding the Company's meat operations as well as for serving as a director of the Company.

(3) In March, 1979, James J. Needham entered into a consulting services agreement with the Company providing for payments to him of an additional $17,000 per annum. This agreement was approved by the Bankruptcy Court on March 23, 1979.

(4) In late 1979, the law firm of Lafontant, Wilkins & Butler of which Jewel S. Lafontant is a partner, was engaged by the Company, subject to Court approval, to perform certain legal services including a review of the Company's equal employment opportunities practices and assist in the development and implementation of an affirmative action plan.

(5) In April, 1980, Joseph L. Castle Associates of which Joseph L. Castle is the Principal was retained by the Company's Retirement Committee to act as a special advisor and consultant. For its services Joseph L. Castle Associates is to be compensated at the rate of $1,000 for each full day and $500 for each partial day, plus expenses.

(d) *Options, Warrants or Rights*

(1) Mr. Gentry holds options to purchase 200,000 shares of the Company's Common Stock at $2.00 per share. (See Item 15(b)(i)(A) above.)

(2) On April 11, 1979, the Board of Directors adopted, subject to the approval of the Bankruptcy Court (which approval was obtained by order dated May 2, 1979), a non-qualified employee stock option plan (the "Option Plan"). Pursuant to the terms of the Option Plan, 150,000 shares of the Company's common stock have been reserved for issuance thereunder. Also, on April 11, 1979, certain of the Company's officers and other key employees were granted nontransferable options under the Option Plan to purchase specified quantities of common stock (100,000 shares in total) at a purchase price per share equal to the mean of the closing bid and asked prices thereof on the date of grant, i.e. $4.44. On May 15, 1979, the Board of Directors granted to an officer an option to purchase 5,000 shares at a price per share of $3.50. On August 9, 1979, the Board of Directors granted to certain officers and other key employees options to purchase an aggregate of 30,000 shares at a price per share of $3.69, and on March 14, 1980, an option was granted to an officer to purchase 10,000 shares at $3.375 per share. As of March 14, 1980, an aggregate (taking into account lapsed options) of 132,500 shares of common stock were covered by outstanding options, of which options covering 70,000 shares were granted to officers as a group including 15,000 shares to Frank N. James. The Plan provides that no option thereunder may be exercised prior to six months after the date of grant thereof.

(e) *Transactions with Management*

Investigations were conducted by Price Waterhouse & Co., independent public accountants, (who retained Pepper, Hamilton & Scheetz, Philadelphia, as legal counsel in such investigations) with respect to transactions between the Company and persons or entities affiliated with the Company's former management in the fiscal year covered by this report (most of whom have resigned since the institution of the Chapter XI proceedings). Based upon its understanding that Price Waterhouse & Co. was addressing and investigating related party transactions (and in view of the expense of approximately $1,700,000 being borne by the Company for such investigation), the Company's present management determined that a duplicative investigation would involve unjustified time, effort and expense, and elected to rely upon the report of Price Waterhouse & Co. Accordingly, neither the Company's present management nor its counsel instituted a separate investigation with respect to related party transactions. On October 15, 1979, Price Waterhouse issued a 620-page report on its investigation. The report disclosed a number of transactions during the five year period prior to October 2, 1978, between the Company and persons or entities affiliated with or related to the Company's former management that had not been disclosed publicly at the time of their occurrence or in public filings relating to the pertinent periods. Among other transactions, these included dealings with certain food brokerage firms including Richman Associates, Inc., the sale of MGS Incentives Company, Inc., a former subsidiary specializing in supermarket promotional campaigns, and subsequent dealings with it, and certain shopping center and other real estate leases and transactions. (See "Related Party and Other Investigations").

In addition to the Price Waterhouse & Co. investigation, a number of the transactions described above are the subject of lawsuits, and may be the subject of an investigation by the Securities and Exchange Commission and by a federal grand jury sitting in the Eastern District of Pennsylvania. (See "Related Party and Other Investigations".)

(f) *Transactions With Pension or Similar Plans*

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 19, 1980

FOOD FAIR, INC.

By JOHN T. GRIGSBY, JR.

John T. Grigsby, Jr.,
Vice President and Treasurer

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

ITEM 12(a) FINANCIAL STATEMENTS AND SCHEDULES

YEARS ENDED JULY 28, 1979 AND JULY 29, 1978

*A report of Laventhol & Horwath has not been included herein with respect to the Company's consolidated financial statements for the fiscal year ended July 29, 1978, since the Company has been informed by Laventhol & Horwath that certain new information provided to Laventhol & Horwath may have an effect on their report. The Company anticipates that a report will be issued. Reference is made to the Company's Annual Report on Form 10-K dated June 15, 1979, for the fiscal year ended July 29, 1978, for the auditors' report dated March 9, 1979 of Laventhol & Horwath contained therein which disclaimed any opinion on the Company's 1978 fiscal year consolidated financial statements.

The individual financial statements of the Registrant have been omitted because the Registrant is primarily an operating company and all subsidiaries included in the consolidated financial statements, in the aggregate, do not have minority equity interests and/or indebtedness to any person other than the Registrant or its consolidated subsidiaries in amounts which together exceed 5 percent of consolidated total assets at July 28, 1979, excluding indebtedness deferred pursuant to the Chapter XI proceedings or incurred in the ordinary course of business which is not overdue and which matures within one year from the date of its creation and indebtedness of subsidiaries collateralized by the Registrant.

Schedules other than those listed above have been omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

See "Qualification" on Cover Page

REPORT OF INDEPENDENT ACCOUNTANTS

Board of Directors and Shareholders
Food Fair, Inc. (Debtor in Possession)
Fort Lauderdale, Florida

We have examined the consolidated balance sheet of Food Fair, Inc. and subsidiaries (debtor in possession) as of July 28, 1979, and the related statements of operations, (deficit) retained earnings and changes in financial position and the additional information listed in the accompanying index of financial statements and schedules for the year then ended. With significant exceptions, as described in the following paragraph, our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The consolidated financial statements for the year ended July 29, 1978, were examined by other auditors whose report thereon, dated March 9, 1979, contained a disclaimer of opinion because of the significance of restrictions on their examination scope for 1978 and uncertainties affecting the consolidated financial statements. As set forth in Note 7, the 1978 consolidated financial statements have been restated to reflect the capitalization of certain leases as required by Statement of Financial Accounting Standards No. 13, and reclassifications have been made to reflect the subsequent discontinuance of the J. M. Fields department store segment. We have reviewed such restatements and reclassifications, and we believe they have been properly applied.

Material weaknesses in the Company's and its subsidiaries' systems of internal control and deficiencies in recordkeeping practices and other conditions described in Note 2 were such that, in a number of instances, present Company employees, many of whom had only recently assumed their current positions, were unable to locate adequate documentation in support of and provide satisfactory explanations for recorded transactions and balances. These conditions precluded us from obtaining sufficient competent evidential matter to satisfy ourselves on the extent to which 1979 operations reflect certain revenues and expenses which relate to prior or future periods and as to whether there are incorrect classifications within the statements of operations and changes in financial position. The Company has initiated programs, not yet fully developed or implemented, to correct material deficiencies in internal control and recordkeeping practices to enable it in the future to regularly prepare reliable operating results and external financial reports on a timely basis.

As more fully described in Note 1, the Company and certain of its subsidiaries sustained substantial operating losses and developed a severe working capital shortage in the fiscal year ended July 29, 1978, and filed petitions under Chapter XI of the Bankruptcy Act, seeking an arrangement of their unsecured indebtedness. On October 2, 1978, the Bankruptcy Court entered an order authorizing the Company to continue as debtor in possession. On April 28, 1980, the Official Creditors Committees approved by a majority vote the elements of a proposed Plan of Arrangement. In order for the Plan to become effective, the shareholders must approve certain corporate changes described in Note 4, and the Plan must be approved by a majority vote, in number and amount, of each class of eligible creditors and confirmed by the Court. The Plan will not be confirmed unless, among other things, the Court finds the Plan to be feasible and in the best interests of the creditors within the meaning of the Bankruptcy Act. In order to generate sufficient cash to effectuate the proposed Plan of Arrangement, the Company must, in some combination, realize net proceeds from its disposition program in excess of the carrying amounts reflected in the balance sheet, settle claims that have been or may be filed with the Court at amounts below the liabilities deferred in the balance sheet, and/or operate profitably enough and obtain additional funds from programs presently under consideration. If the Chapter XI proceedings are not concluded by confirmation of a plan of arrangement, we are advised that it is possible that the proceedings will be transferred to the Corporate reorganization provisions of Chapter X of the Act and a Trustee appointed, or the Company may be adjudicated a bankrupt and its assets liquidated.

As described in Notes 5 and 6, the Company is defendant in a number of lawsuits, is the subject of ongoing investigations by the Securities and Exchange Commission and a Federal grand jury, and has other significant contingencies. Further, since October 2, 1978, the Company has: 1) sustained significant losses prior to and in connection with discontinuance of its J. M. Fields discount department store segment and closing of more than half of its supermarket operations, and has entered into a program to dispose of the related assets; 2) sustained significant losses in the year ended July 28, 1979, from the ongoing supermarket operations; and 3) been notified that upon termination of the Chapter XI proceedings, the U.S. Department of Agriculture intends to terminate its license under the Perishable Agricultural Commodities Act (PACA), and it is unable to predict with certainty whether such license, which it believes is essential to its business, can be renewed on terms within its financial resources.

The accompanying consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern which contemplate the realization of assets and liquidation of liabilities in the normal course of business and at the amounts stated in the accompanying consolidated balance sheet. The Company's ability to continue as a going concern is dependent on its:

—obtaining the approval of the shareholders for prerequisite corporate changes and the approval of the creditors and the confirmation by the Court of a plan of arrangement;

—achieving profitable operations and generating cash sufficient to comply with terms of a confirmed plan of arrangement and then reestablishing and sustaining normal trade credit terms with suppliers;

—obtaining adequate financing for the future needs of the Company, including that needed to complete its Capital Improvements Program;

—completing the development of and implementing satisfactory systems of internal control and recordkeeping practices so that it is able to prepare reliable operating and external financial reports on a timely basis;

—favorably resolve pending litigation, Federal grand jury and SEC investigations, and other contingencies referred to in Notes 5 and 6; and

—renewing its PACA license.

Should the Company be unable to satisfactorily resolve the material uncertainties listed above, it would likely be unable to continue as a going concern and/or be adjudicated a bankrupt, and it would be required to realize its assets and liquidate its liabilities in other than the normal course of business and possibly at amounts materially different from those included in the accompanying consolidated balance sheet.

In 1979 as described in Note 7, the Company adopted new methods of accounting with which we concur, as a result of which the Company now charges warehousing costs and payroll taxes to operations as incurred.

Material weaknesses in the Company's and its subsidiaries' systems of internal control and deficiencies in their recordkeeping practices prevented the Company, and therefore us, from obtaining sufficient evidence to provide the disclosures required by generally accepted accounting principles that have been omitted as described in Note 2.4 and to ascertain the extent to which 1979 results of operations reflect incorrect classifications and include revenues and expenses which relate to prior or future periods, including:

1. the portion, which would be significant, of the $14,500,000 adjustment for self-insurance described in Note 2.3, which applies to years prior to 1979, and
2. the extent, if any, to which the provision for creditors' claims, as described in Note 2.1, applies to years prior to 1979.

Also, it is not possible to determine the effect on all of the accompanying 1979 consolidated financial statements of such adjustments as might have been required had the outcome of the material uncertainties relating to the Company's continuation as a going concern been known. Accordingly, we are unable to and do not express an opinion on the accompanying consolidated financial statements referred to in the first paragraph of this report.

TOUCHE ROSS & CO.
CERTIFIED PUBLIC ACCOUNTANTS

Philadelphia, Pennsylvania
May 7, 1980

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

Years Ended July 28, 1979 and July 29, 1978

Going concern

The accompanying consolidated financial statements are prepared on the basis of the continuation of the Company as a going concern which contemplates the realization of assets and liquidation of liabilities in the normal course of business; except that interest on certain indebtedness has not been accrued since October 2, 1978, the date of filing petitions for an arrangement under Chapter XI of the Bankruptcy Act and certain disaffirmed lease obligations have been reduced in the accompanying consolidated financial statements to reflect the anticipated application of provisions of the Bankruptcy Act. As indicated in Note 1, "Significant matters," and elsewhere in the notes to consolidated financial statements, the Company's ability to realize its assets and liquidate its liabilities in the normal course of business is dependent upon the currently indeterminable outcome of a number of significant uncertainties.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly and majority owned subsidiaries, except its life insurance company and credit company. All significant intercompany profits, balances and transactions have been eliminated (Note 2.2).

Discontinued J. M. Fields and closed supermarket operations

Operations terminated during the fiscal year ended July 28, 1979, and the assets and liabilities thereof have been accounted for in accordance with the following policies:

Operations

The consolidated statements of operations and changes in financial position for the year ended July 29, 1978, have been reclassified retroactively to show separately the loss from operations of the discontinued J. M. Fields department stores. The results of operations of closed supermarket operations to February 10, 1979 are set forth in Note 3.2. Separate provisions have been made in 1979 for losses from disposal of properties and termination expenses of the discontinued J. M. Fields department store and closed supermarket operations, representing losses incurred during the disposal period and allowances required to reduce the assets of discontinued and closed operations to estimated realizable amounts. The provisions include estimates of incurred and future carrying and selling costs and estimated losses which have been or are expected to be incurred upon the sale or liquidation of such assets less gains which have been or are expected to be realized from the sales of certain properties.

Net assets held for disposition

Assets of discontinued and closed operations and other assets not essential to ongoing operations, stated at estimated net realizable amounts and reduced by related liabilities, are combined in the consolidated balance sheet of July 28, 1979 (Note 3.3).

Inventories

Inventories are stated at the lower of cost or market, with cost being determined as follows: Inventories in stores—retail inventory method; inventories in warehouses—principally average cost; inventories at manufacturing facilities and supplies—first-in, first-out method.

See "Qualification" on Cover Page

FOOD FAIR, INC.
(DEBTOR IN POSSESSION)

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

Years Ended July 28, 1979 and July 29, 1978

Property and equipment and depreciation

Property and equipment is stated at cost. Facility and equipment leases having the substance of financing transactions have been capitalized, and related lease obligations for leases of property in current use have been included in liabilities. Depreciation is computed by the straight-line method over the estimated useful lives of the assets, as follows:

Buildings	20-35 years
Fixtures and equipment	3-10 years
Capitalized lease assets	15-25 years

Leasehold improvements are amortized over periods ranging from 10 to 20 years, representing the shorter of the term of the lease or the estimated life of the improvements.

Expenditures for maintenance and repairs, which in 1979 and 1978 may not be indicative of normal levels of expenditure, are charged to operations and major renewals and betterments are capitalized. Costs and related accumulated depreciation of properties sold or otherwise retired have been eliminated from the accounts, and gains and losses on disposition are reflected in operations.

Loss per share of common stock

Loss per share of common stock is stated after applicable preferred stock dividends and is based on the weighted average number of shares outstanding during each year. The average number of shares outstanding has not been adjusted to include stock options, warrants, and convertible subordinated notes because their inclusion in the calculation would be anti-dilutive.

Changes in accounting principles

In the fourth quarter of 1979, in order to be consistent with industry practices, the Company changed its methods of accounting and now charges warehousing costs and payroll taxes to operations as incurred. The cumulative effect of these changes from prior years was charged to operations in 1979. In addition, the 1978 financial statements have been restated for retroactively capitalizing leases in order to comply with the provisions of Statement of Financial Accounting Standards No. 13. The cumulative effect of this change from prior years was charged to operations in 1978.

Income taxes

Deferred income taxes are provided for timing differences, principally depreciation expenses and insurance claims receivable.

Pensions

Pension expense charged to operations includes normal cost and amortization of prior service costs over a 40-year period. Pension costs are funded as accrued, except that a waiver has been obtained whereby 1978 costs for certain pension plans will be funded over a 15 year period.

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

CONSOLIDATED BALANCE SHEETS

ASSETS

(In Thousands)

	July 28, 1979	July 29, 1978 Restated (Note 7)
Current assets:		
Cash (includes short-term investments of $4,813 in 1979)	$ 27,505	$ 18,604
Restricted cash (Note 3)	9,698	
Accounts receivable, net of allowance for doubtful accounts of $3,257, 1979 and $2,062, 1978	12,047	20,017
Inventories	85,602	267,063
Other current assets	1,643	9,265
Total current assets	136,495	314,949
Restricted cash—noncurrent (Note 3)	49,676	
Net assets held for disposition (Note 3)	83,390	
Investments and other assets (Note 9)	11,575	34,336
Property and equipment (Notes 10 and 11):		
Land	7,323	27,499
Buildings	27,653	90,660
Capitalized leased assets	100,170	361,895
Leasehold improvements	17,822	57,572
Fixtures and equipment	59,656	129,084
	212,624	666,710
Less accumulated depreciation and amortization	(104,029)	(303,312)
	108,595	363,398
	$389,731	$712,683

See notes to consolidated financial statements and statement of significant accounting policies.

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

CONSOLIDATED BALANCE SHEETS

LIABILITIES, REDEEMABLE PREFERRED AND COMMON STOCKS, AND OTHER ELEMENTS OF (DEFICIENCY IN ASSETS) SHAREHOLDERS' EQUITY

(In Thousands)

	July 28, 1979	July 29, 1978 Restated (Note 7)
Current liabilities:		
Notes payable (Note 10)	$ 15,000	$ 36,685
Accounts payable	24,636	146,078
Accrued salaries and expenses	37,160	47,514
Current portion:		
Long-term debt (Note 10)	7,743	124,954
Capitalized lease obligations (Note 11)	5,855	16,668
Total current liabilities	90,394	371,899
Liabilities deferred pursuant to proceedings under Chapter XI (Note 4)	388,582	
Capitalized lease obligations (Note 11)	60,839	231,387
Long-term debt (Note 10)	10,908	58,147
Other non-current liabilities		1,140
Deferred income taxes	1,771	1,771
Commitments and contingencies (Notes 1, 4, 5, 6, 9, 11, 14 and 15)		
Total liabilities	552,494	664,344
Redeemable preferred stock, $4.20 cumulative; $15 par value; 108,190 shares authorized of which 16,190 in 1979 and 16,265 in 1978 are issued and outstanding; stated at redemption value of $100 per share (Note 12)	1,619	1,627
Common stock, par value $1 per share; 10,000,000 shares authorized of which 7,557,378 are issued in each year (Note 13)	7,557	7,557
Other elements of (deficiency in assets) shareholders' equity:		
Capital in excess of par	51,241	51,239
Deficit	(221,843)	(10,747)
Cost of 199,101 common shares in treasury	(1,337)	(1,337)
	$389,731	$712,683

See notes to consolidated financial statements and statement of significant accounting policies.

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

STATEMENTS OF CONSOLIDATED OPERATIONS

Years Ended July 28, 1979 and July 29, 1978

(In Thousands)

	1979	1978 Restated (Notes 3 and 7)
Revenues:		
Sales	$1,487,270	$2,414,665
Other income, net	4,973	7,255
	1,492,243	2,421,920
Costs and expenses:		
Cost of sales	1,216,027	1,978,642
Provision for creditors' claims (Note 2)	23,804	
Operating and administrative expenses	326,657	447,700
Interest expense, net (Note 10)	16,506	39,065
	1,582,994	2,465,407
Loss from continuing operations before unusual items and income tax credit	(90,751)	(43,487)
Unusual Items:		
Disposal of properties and termination expenses, including net loss from closed supermarket operations after February 10, 1979 (Note 3)	(35,636)	
Adjustment for self-insurance, a significant portion of which applies to prior years (Note 2)	(14,523)	
Bankruptcy administration costs, less interest income of $2,107 on restricted cash	(5,628)	
Loss from continuing operations before income tax credit	(146,538)	(43,487)
Income tax credit (Note 14)		8,776
Loss from continuing operations	(146,538)	(34,711)
Loss from discontinued J. M. Fields operations (Notes 2 and 3):		
From operations, including provision for creditors' claims of $10,096 in 1979	(47,659)	(19,840)
From disposal of properties and termination expenses, including net loss from operations after February 10, 1979	(11,319)	
	(58,978)	(19,840)
Loss from operations, before cumulative effect of accounting changes	(205,516)	(54,551)
Cumulative effect of accounting changes (Note 7)	(5,563)	(37,672)
Net Loss	($211,079)	($92,223)
Net Loss per share of common stock:		
Continuing operations	($19.92)	($4.72)
Discontinued J. M. Fields operations	(8.02)	(2.70)
Cumulative effect of accounting changes	(.76)	(5.12)
	($28.70)	($12.54)
Pro-forma net loss amounts assuming accounting changes applied retroactively:		
Continuing operations	($146,538)	($35,295)
Discontinued J. M. Fields operations	(58,978)	(19,840)
Net Loss	($205,516)	($55,135)
Per share of common stock:		
Continuing operations	($19.92)	($4.81)
Discontinued J. M. Fields operations	(8.02)	(2.70)
Net Loss	($27.94)	($7.51)

See notes to consolidated financial statements and statement of significant accounting policies.

See "Qualification" on Cover Page

FOOD FAIR, INC.
(DEBTOR IN POSSESSION)

CONSOLIDATED STATEMENTS OF (DEFICIT) RETAINED EARNINGS

Years Ended July 28, 1979 and July 29, 1978

(In Thousands)

	1979	1978
Balance, beginning	($ 10,747)	$ 81,250
Increase in equity in unconsolidated subsidiary from its adoption of SFAS No. 13		1,769
Balance, beginning (as restated)	(10,747)	83,019
Net Loss	(211,079)	(92,223)
	(221,826)	(9,204)
Cash dividends paid:		
Preferred Stock ($1.05 per share in 1979 and $4.20 per share in 1978)	17	71
Common Stock ($.20 per share)		1,472
	17	1,543
Balance, ending	($221,843)	($10,747)

See notes to consolidated financial statements and statement of significant accounting policies.

FOOD FAIR, INC.
(DEBTOR IN POSSESSION)

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years Ended July 28, 1979 and July 29, 1978
(In Thousands)

	1979	1978 Restated (Notes 3 and 7)
Application of Funds:		
Operations:		
Loss from continuing operations	$146,538	$ 34,711
(Charges) credits not affecting working capital:		
Provisions for losses on net assets held for disposition	(33,128)	
Provision for creditors' claims and adjustment for self-insurance	(38,327)	
Depreciation and amortization	(24,071)	(31,192)
Excess of obligations over related assets of disposed capitalized leases	37,628	
Cumulative effect of accounting changes	5,563	37,672
Other	(8,891)	13,726
Funds used in continuing operations	85,312	54,917
Loss from discontinued J. M. Fields operations	58,978	19,840
(Charges) credits not affecting working capital:		
Provision for creditors' claims	(10,096)	
Provisions for losses on assets held for disposition	(9,759)	
Depreciation and amortization	(2,982)	(6,375)
Funds used in discontinued J. M. Fields operations	36,141	13,465
Total funds used in operations	121,453	68,382
Reclassification of working capital of closed and discontinued operations to net assets held for disposition	138,166	
Deferred disposition losses net of gains, and loss from operations after February 10, 1979	78,595	
Increase in restricted cash, investments and other assets	60,905	5,299
Purchase of property and equipment	11,981	31,862
Leased assets		190,628
Current maturities and payments of long-term debt	16,959	128,440
	428,059	424,611
Source of Funds:		
Deferral of current liabilities pursuant to proceedings under Chapter XI	340,159	
Carrying value of assets disposed	179,517	
Capitalized lease obligations		230,825
Proceeds from:		
Disposition of property and equipment		16,555
Long-term debt		12,174
Other, net	11,434	(157)
	531,110	259,397
Increase (decrease) in working capital	$103,051	($165,214)
Working Capital Changes—increase (decrease):		
Cash	$ 18,599	$ 7,974
Accounts receivable	(7,970)	(3,918)
Inventories	(181,461)	5,624
Other current assets	(7,622)	(1,549)
Notes payable	21,685	(18,269)
Accounts payable	121,442	(41,189)
Accrued salaries and expenses	10,354	(4,748)
Current portions of long-term debt and capitalized lease obligations	128,024	(109,139)
	$103,051	($165,214)

See notes to consolidated financial statements and statement of significant accounting policies.

See "Qualification" on Cover Page

FOOD FAIR, INC.
(DEBTOR IN POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended July 28, 1979 and July 29, 1978

(Figures in tables in thousands)

1. Significant matters

Recurring losses from unprofitable J. M. Fields discount department store operations and from declining supermarket profitability culminated in the Company's sustaining substantial losses from operations and developing a severe working capital shortage in its fiscal year ended July 29, 1978, and filing, on October 2, 1978, petitions under Chapter XI of the Bankruptcy Act. On that date, the United States District Court for the Southern District of New York (Court) entered an order authorizing the Company and certain subsidiaries to continue operations as debtors in possession.

As described more fully in Item 5, "Legal Proceedings," elsewhere herein, the Company is defendant in a number of lawsuits, the ultimate outcome of which are not presently determinable. Under the provisions of the Bankruptcy Act, the filing of Chapter XI petitions gave rise to an automatic stay of all actions against the filing companies; however, upon confirmation of a plan of arrangement, the actions may be resumed.

In addition, the Company is the subject of an ongoing investigation by the Securities and Exchange Commission of transactions between the Company and certain parties (Note 5) and to determine the adequacy of the Company's financial disclosures in the period preceding the filing of the Chapter XI petitions (Notes 2, 4 and 17). The Commission has given no indication of whether any proceedings against the Company are contemplated. A Federal grand jury is also investigating transactions with certain parties.

1.1 Since commencement of the Chapter XI Proceedings, the Company has:

- sustained additional substantial operating losses while discontinuing its J. M. Fields discount department store segment and closing certain supermarket and other operations pursuant to implementing its strategy of continuing to operate as a unitary segment only its food operations located in areas where Food Fair is significant in the marketplace and other factors appear favorable to success;
- appointed a new Chairman and Chief Executive Officer and other new executive personnel to replace former senior management, most of whom had resigned;
- realigned its organizational structure;
- entered into a program to liquidate or dispose of certain assets, including those of discontinued J. M. Fields and closed supermarket operations;
- and is developing, initiating and implementing policies and programs to correct significant pre-existing and continuing deficiencies in the Company's system of internal control;
- negotiated and proposed a Plan of Arrangement, the elements which were approved in principle by the Official Creditors' Committees on April 28, 1980. If such Plan is not accepted and confirmed, the Chapter XI proceedings may be transferred to the corporate reorganization provisions, Chapter X of the Act, and a trustee appointed or the Company may be adjudicated a bankrupt and its assets liquidated;
- received approval from the Creditors' Committees and the Court for a five-year capital improvements program involving the expenditure of $205,000,000;

See "Qualification" on Cover Page

- been notified that the U.S. Department of Agriculture is investigating whether violations of the Perishable Agricultural Commodities Act were committed, as a result of nonpayment of obligations to certain produce suppliers for goods sold and delivered. At the present time no action has been taken to terminate the present license under the Act. The Company is negotiating for a settlement which would allow it to continue as a business licensed under the Act after conclusion of the Chapter XI proceedings, but is unable to predict if such license (which it believes is essential to its business) can be obtained, or obtained on terms within its financial resources;
- transferred its executive offices to facilities in Ft. Lauderdale, Florida, closer to its continuing operations; and
- developed an in-house electronic data processing function.

1.2 The Company's consolidated financial statements have been prepared on the basis of principles of accounting applicable to a going concern (see statement of significant accounting policies). The continuation of the Company as a going concern is dependent upon its ability to:

- obtain the requisite approval of the creditors and confirmation by the Court of a plan of arrangement, and approval of the stockholders for requisite corporate changes;
- generate sufficient cash to effectuate a plan of arrangement;
- operate profitably enough to meet ongoing obligations arising from a confirmed plan of arrangement over a sustained period;
- develop and implement satisfactory systems of internal accounting control and recordkeeping practices such as would enable the Company to report reliable operating and financial information on a timely basis;
- continue normal credit terms with suppliers and other creditors, and obtain adequate financing for the future needs of the Company;
- satisfactorily resolve pending litigation and other contingencies described herein and elsewhere in the notes to consolidated financial statements; and
- obtain adequate financing to implement the Capital Improvements Program.

2. Significant accounting and internal control conditions

As stated herein and elsewhere in notes to consolidated financial statements, the accompanying consolidated financial statements omit certain disclosures, as described in paragraph 2.4 below, required by generally accepted accounting principles, and certain 1979 charges to operations described in paragraphs 2.1 and 2.3 below do or appear as if they may pertain in part to operations of prior years.

2.1 Provision for creditors' claims: The Company has provided $31,900,000 for amounts claimed by suppliers and $2,000,000 for amounts claimed by lenders in excess of liability balances recorded in the Company's accounts. The Company has begun, but not completed, the process of identifying and analyzing differences between these claims and recorded liabilities. This process will not be completed until all claims have been received and authenticated and appropriate orders have been entered by the Court. Upon completion, adjustments may be required to properly reflect amounts due claimants. It is possible that a portion of the provision for creditors' claims represents liabilities incurred prior to commencement of the fiscal year ended July 28, 1979. Amounts, if any, which pertain to prior periods cannot presently be reasonably estimated because of deficiencies in the internal accounting controls and recordkeeping procedures and employee turnover, and because the claims reconciliation and authentication procedures have not been completed.

2.2 Deficiencies in internal accounting controls and recordkeeping procedures: Material deficiencies in the Company's systems of internal accounting control and recordkeeping practices have been found to exist and have been exacerbated by the dislocations engendered by the Company's pending Chapter XI Proceedings, including ongoing negotiations with creditor groups, the termination of more than half of its prior operations, significant turnover in management, financial and accounting personnel, and relocation of corporate headquarters and corporate records, and changes in accounting systems.

Immediately after commencement of Chapter XI Proceedings early in the 1979 fiscal year, the Company installed temporary operating systems, designed to identify principal factors contributing to substantial operating losses that were being incurred and to enable evaluation of the prospects of eliminating such losses. Such systems were not designed to assure the generation and control of accounting data, such as are required to prepare financial statements conforming with generally accepted accounting principles. Because of the material deficiencies in the Company's internal accounting controls and recordkeeping practices, it was not possible for the Company to reconstruct accounting records that would be required to provide assurances that its 1979 consolidated financial statements are prepared in accordance with generally accepted accounting principles. Accordingly, in their report dated May 7, 1980 on examination of the consolidated financial statements for the year ended July 28, 1979, the Company's current independent certified public accountants have reported that they have not been able to complete tests of the accounting records and other auditing procedures that they consider necessary in order to comply with generally accepted auditing standards.

The Company's former independent certified public accountants cited serious accounting and recordkeeping deficiencies which they said developed during the year ended July 29, 1978, that rendered financial records of the J. M. Fields discount department store operations inadequate for the purpose of properly recording sales and purchases and maintaining reliable records of accounts payable and inventories, and which enter materially into the determination of financial position, results of operations, and changes in financial position. They also reported that inadequacies in the system of internal accounting controls made it impracticable for them to carry out sufficient auditing tests and procedures which they deemed necessary to comply with generally accepted auditing standards.

The elimination of intercompany payables and receivables necessitated a credit to accounts payable of $2,098,000 in 1979 and a charge to operating and administrative expenses of $2,321,000 in 1978, representing the unreconciled excess of receivables and payables among the Company and its consolidated subsidiaries.

2.3 Adjustment for self-insurance: Based, in part, on a review by an independent insurance broker, management has provided for substantial anticipated self-insurance losses in 1979. Approximately $14,500,000 of such provision is presented as an unusual item in the 1979 consolidated financial

See "Qualification" on Cover Page

statements because an adjustment is required for claims incurred in prior years, and present management believes that reasonable estimates could have been made for such claims in the years in which they were incurred and appropriate claims reserves recorded. The consolidated financial statements of prior years have not been restated because, on the basis of presently-available data, management is unable to determine how the provision should be allocated among the current and each prior year during which any such claim was outstanding. Appropriate analyses of claims submitted, if made in prior years, are not available; and restatement would require individual examination of each claim (including thousands of closed claims), and making numerous, often arbitrary, assumptions about what was known about each such claim in each fiscal period. Also some of the provision is for claims against the discontinued J. M. Fields operations. At July 29, 1978 an estimate of $1,594,000 was included in current liabilities for settlement of self-insured individual claims.

2.4 Incomplete disclosure: Due to the unavailability of information, the Company has not disclosed the amounts of investment tax credit carryforwards, loss from discontinued J. M. Fields operations for the period from February 10, 1979 to July 28, 1979, and operating lease rentals and commitments or presented unaudited quarterly financial information for the years ended July 28, 1979 and July 29, 1978 (Note 17). These disclosures are required by generally accepted accounting principles.

3. Discontinued J. M. Fields and closed supermarket operations

In conjunction with the Chapter XI Proceedings, the Company, operating as debtor in possession, has developed a strategy for restoring profitable operations and concluding a plan of arrangement satisfactory to both its creditors and the Court. Pursuant thereto, the Company has discontinued its J. M. Fields discount department store operations and closed approximately 50% of its supermarkets, all of its meat processing and certain of its produce operations. The Company is in the process of disposing of its interests in property and other assets related to such operations and of disposing of or liquidating other assets not essential to its ongoing operations. The proceeds from disposition or liquidation of the bulk of such assets are required by court orders and/or informal agreements with the Creditors' Committees to be segregated from operating accounts and restricted for specified purposes summarized below and to make initial payments called for under a proposed plan of arrangement (Note 4).

3.1 Discontinued J. M. Fields operations: In January, 1979, the Company decided to dispose of its 79 J. M. Fields discount department stores, and on April 17, 1979, the Court authorized the Company to discontinue such operations. Revenues from discontinued operations from July 30, 1978, to February 10, 1979 and for the year ended July 29, 1978, were $143,842,000 and $371,266,000 respectively.

The Company intends to sell the remaining properties in which it owns leasehold or residual interests, and related fixtures and to liquidate remaining receivables, and other assets of discontinued operations at planned dates through December, 1980. Aggregate disposition proceeds from liquidation of the other assets, principally inventories, through July 28, 1979, approximated $45,000,000.

3.2 Closed supermarket operations: The Company closed 222 stores in its closed regions of which 210 were closed pursuant to Court approval and decided to sell substantially all property and equipment and to sell or otherwise dispose of all leaseholds related to closed supermarket operations.

(Figures in tables in thousands)

A substantial portion of such assets have already been sold. The results of operations of closed supermarkets to February 10, 1979, the final measurement date as to closings, are as follows:

	1979
Revenues	$467,339
Costs and expenses:	
Costs of sales	396,383
Provision for creditors' claims	10,746
Operating and administrative expenses	119,098
Allocated interest expense, net	4,730
	530,957
Operating loss	($ 63,618)

In addition, the Company has or is seeking to dispose of its leasehold or residual interests in real property not presently involved in the Company's ongoing operations. These properties (initially approximately 200) include vacant discount department store and supermarket locations, warehouse facilities, manufacturing plants, an administrative facility, and unimproved real estate located along the eastern seaboard of the United States, California, and the Bahamas.

3.3 Net assets held for disposition: Net assets held for disposition have been included in the balance sheet at estimated net realizable amounts and consist of the following:

	July 28, 1979
Historical costs and deferred charges:	
Property and equipment, net	$177,104
Investment in Amterre	9,904
Receivables and other, net	23,431
Deferred disposition losses net of gains, and loss from operations February 10, 1979 to July 28, 1979	78,595
	289,034
Estimated excess of recorded and future costs over proceeds through the end of the disposition program	(42,887)
Estimated net realizable value of assets held for disposition	246,147
Related liabilities:	
Mortgage loans payable	(35,837)
Capitalized lease obligations	(120,560)
Deposits on future sales	(6,360)
	(162,757)
Net assets held for disposition	$ 83,390

3.4 Restricted cash: Pursuant to court orders or informal agreements with the Creditors' Committees, the Company has placed a substantial portion of the proceeds realized from its disposition program in segregated bank accounts or interest bearing funds. On July 28, 1979, segregated funds are restricted for the following purposes:

(Figures in tables in thousands)

Trust fund for payment of obligations incurred after October 2, 1978, and available to effectuate the Plan of Arrangement with creditors	$25,000
Net reimbursement to Company for payments made in connection with certain store closings and operations and asset dispositions	9,698
Satisfaction of claims of the creditors of Realmart, Inc. (a wholly-owned subsidiary, not in bankruptcy) and subsidiaries	4,352
Payments under employment agreement with the Company's current President and Chief Executive Officer (Note 11.2)	2,067
Payment of payroll tax liabilities	1,566
	42,683
Not presently specified	16,691
	59,374
Less current portion	(9,698)
	$49,676

The proceeds from the sale of the properties owned by Realmart, Inc. and its subsidiaries are to be segregated either individually or in joint accounts. These escrow accounts are subject to further orders of the Court and subject to the claims of interest of creditors of Realmart and its subsidiaries. In order to facilitate the investment of these funds and to maximize the interest earned on the monies which are being held for the benefit of its creditors, the Company is including the Realmart proceeds with the other net disposition proceeds for investment purposes. The Company is however separately accounting for the Realmart proceeds and can identify these funds.

Disbursements from the restricted accounts are subject to Court authorization and/or Creditors' Committees approval. On October 4, 1979, the Court and Creditors' Committees approved use of up to $25,000,000 of restricted funds in the Company's Capital Improvements Program.

In light of material deficiencies in the Company's system of internal accounting control and record-keeping practices (Note 2.2) as well as the lack of precision of court orders and informal agreements regarding restricted cash it is possible that certain transactions may not have been appropriately recorded or classified in the Company's records before affecting restricted cash accounts. However, in the opinion of management, the requirements of court orders and informal agreements have been met to the best of its ability under the circumstances.

4. Proposed Plan of Arrangement

Immediately prior to October 2, 1978 when the Company and nine of its subsidiaries filed petitions for an arrangement under Chapter XI of the Bankruptcy Act, suppliers discontinued extending the Company trade credit under normal terms, and the Company was unable to extend short-term bank loans as they fell due or to obtain credit from other sources. Estimated losses from operations were believed by then to have reduced the Company's net worth below that required to be maintained under the Company's loan agreements with certain lenders. For these and other reasons, all of the Company's institutional indebtedness would likely have become due immediately, under the terms thereof, in which event the Company would have been faced with the prospect of having its bank accounts offset against outstanding indebtedness.

The Company, therefore, sought the protection of the Court from individual creditor actions under the provisions of the Bankruptcy Act to enable it to pursue its plans for restoring profitable operations while it is negotiating a plan of arrangement with its creditors. In order to emerge from Chapter XI Proceedings, a plan of arrangement proposed by the Company must be approved by a majority, in number and amount, of each class of the Company's unsecured creditors who have filed claims and are eligible to vote, and must, among other things, be found by the Court to be feasible and in the best interests of the creditors within the meaning of the Bankruptcy Act.

The proposed Plan of Arrangement has defined seven classes of creditors who have filed approximately 15,000 claims aggregating approximately $497,000,000 as of April 22, 1980, which excludes approximately 2,500 amended, duplicated or expunged claims aggregating approximately $214,000,000. The claims filed are substantially in excess of recorded amounts of $388,600,000 and are not necessarily indicative of the amounts at which they will be settled.

Authorization of new classes of preferred stock and an increased number of authorized common shares as contemplated in the proposed Plan of Arrangement must be approved by the Company's shareholders.

On April 28, 1980, a majority of the Official Creditors' Committees of Food Fair, Inc., approved the revised elements of the Plan of Arrangement for resolution of creditors' claims. The Plan was filed with the Court on May 7, 1980. See Item 1—Proposed Plan of Arrangement.

5. Transactions with certain parties

On December 8, 1978, the Company with Court authorization retained the firm of Price Waterhouse & Co., independent certified public accountants, to conduct an extensive in-depth investigation of related party transactions. In January, 1979, the Securities and Exchange Commission issued an Order of Investigation for the purpose of examining various transactions between the Company and such related or affiliated parties and to examine the adequacy of the Company's financial reports and disclosures for a period of years prior to the filing of the Chapter XI petition. The Price Waterhouse & Co. investigation included among other things, a review and analysis of transactions between the Company and (1) entities controlled by or related to it or its present and former officers or directors (including entities in which such present and former officers and directors may have an interest) and (2) shareholders of the Company within a period of five years prior to the filing of the Chapter XI petition and the continuing period subsequent thereto.

In February, 1979, the Board of Directors approved a policy that all dealings with third parties, including suppliers and customers, should be based solely on objective criteria such as price, quality and service. The Board also approved the following actions of management:

1) Adoption and distribution to officers and other key personnel of policies regarding conflicts of interest and improper payments, and

2) Notification of suppliers that they can transact business directly with the Company or through intermediaries of their own choosing rather than through intermediaries related to former or current management.

Business relationships between the Company and certain parties subsequently identified in the Price Waterhouse report have terminated. Transactions with other such parties have continued, however, management is not aware of any impropriety in connection with any of these ongoing relationships or that they have been based on anything other than the objective criteria mentioned above.

Price Waterhouse issued its report on transactions with related parties on October 15, 1979. The report states that 55 related party transactions or relationships were identified. Many of the transactions or relationships described involved members of the family of Samuel Friedland, the founder of the Company, their relatives or entities controlled by them. The report advises that notwithstanding the disclosures made therein, it does not set forth and Price Waterhouse & Co. has "specifically not formed any conclusions with respect to the legality or propriety of the conduct of any person or entity."

On November 1, 1979, the Board of Directors authorized the Audit Committee, composed entirely of non-management directors, to evaluate the report and to determine what disposition the Company should make of all matters involving related parties and of shareholder suits concerning former management.

On December 17, 1979, the Company was served with a subpoena from a Federal grand jury in the Eastern District of Pennsylvania requesting internal audit documents. The Company has no indication as to what action, if any, may be taken by either the grand jury or the Securities and Exchange Commission. If, as a result of these investigations or the operations of the policies described above, it becomes apparent that additional actions are called for, current management intends to act appropriately.

The following disclosures include only those related entities with whom a significant volume of business was transacted during 1978.

Hasam Realty Corp. (Hasam):

The voting stock of Hasam is owned 100% by Samuel Friedland, a former officer and director of the Company, and by members of his family. Hasam is the owner of approximately 14% of the Company's common stock. The Company leases two retail store locations from Hasam under leases which provide for minimum annual rentals of $276,000 through 1990, exclusive of taxes, insurance and other occupancy costs. Rentals have been paid under these leases.

Filigree Foods, Inc. (Filigree):

During 1976 Hasam acquired 49% of the common stock of Filigree and warrants to acquire an additional 10%. Filigree, a wholesale grocery company, had previously supplied the Company's supermarkets primarily in the metropolitan New York area prior to their closing.

See "Qualification" on Cover Page

(Figures in tables in thousands)

The Company purchased approximately $123,000,000 from Filigree during 1978. In November, 1978 Filigree filed petitions under Chapter XI of the Bankruptcy Act seeking an arrangement of their respective indebtedness and liabilities.

Richman Associates (Richman):

Richman is a brokerage firm in which Harold Friedland, a former officer and director of the Company, is the controlling partner. Since the Company's records reflect only the purchases from suppliers, and not the identity of any broker who may have represented the suppliers, it is not practicable for the Company to determine the volume of transactions in which Richman acted as broker for suppliers selling to the Company.

MGS Incentives Company (MGS):

In December 1976, the Company sold its interest in MGS to an entity controlled by Harold Friedland, a former officer and director of the Company. MGS has administered certain of the Company's supermarket promotional campaigns. Fees are based upon the value of promotional merchandise utilized. The Company paid MGS $3,400,000 in 1978.

See Note 9 for disclosure of other matters regarding related parties.

6. Legal proceedings and contingencies

The Company has been named as defendant in several class and derivative actions and various other lawsuits and claims have been filed against it. In addition, as a result of its bankruptcy proceedings (Note 4) and non-payment of various obligations, or both, the Company and various of its subsidiaries are or may be in default under numerous loan agreements, indentures, promissory notes, guarantees, leases of real and personal property, security agreements, mortgages, and other contractual arrangements. Also, the Company self-insures individual claims of $250,000 ($100,000 prior to July 10, 1978) or less for workmen's compensation, automobile and general liability risks, and may be required to pay claimants amounts greater than those accrued, including amounts for claims not yet filed. Additional information on legal proceedings and contingencies is included in Item 1 under the captions, "Employee Relations" and "Related Party and Other Investigations" and in Item 5.

7. Accounting changes

In the fourth quarter of 1979, the Company changed certain methods of accounting in order to be consistent with industry practices as follows: (1) the exclusion of warehousing costs in the determination of supermarket inventories; and (2) the discontinuance of amortizing payroll tax expense over the entire year. Henceforth warehousing costs and payroll taxes will be charged to income as incurred.

The effects of these changes are included in the current year's operations as follows:

	Current Year Benefit	Cumulative Effect Prior Years
Warehouse costs	$1,555	$3,195
Payroll taxes	1,536	2,368
	$3,091	$5,563

See "Qualification" on Cover Page

(Figures in tables in thousands)

Effective in August 1978, the Company changed its method of accounting for certain prior years' leases to comply with the provisions of Statement of Financial Accounting Standards No. 13. Therefore, the consolidated financial statements reflect the retroactive capitalization of leases and the restatement of the consolidated financial statements for 1978. Years ending prior to July, 1978 have not been restated retroactively due to incomplete information with respect to leases for those years. The effect of the accounting change was to increase net loss by $613,000 in 1979. A summary of the effects of restating the 1978 consolidated financial statements is as follows:

	Adoption of SFAS No. 13	Equity Investees Adoption of SFAS No. 13
	Increase/(Decrease)	
Investments	$	$1,763
Property and equipment, net	190,628	
Capitalized lease obligations	230,327	
Deficit, retained earnings	39,699	(1,769)
Operating and administrative expenses	(16,362)	
Interest expense, net	18,389	
Other income, net		(6)
Cumulative effect of accounting change	(37,672)	

8. Inventories

Inventories consist primarily of supermarket merchandise in 1979 and supermarket and discount store general merchandise in 1978. In 1979 inventories used in the determination of cost of sales are $85,602,000. In years 1978 and 1977 inventories used in the determination of cost of sales as previously reported were $267,053,000 and $261,439,000.

9. Investments and other assets

	1979	1978
Investments:		
Washington Square Life Insurance Co.	$ 3,984	$ 4,185
Amterre Development Inc		9,084
Other	232	1,651
	4,216	14,920
Deposits with vendors, net of allowance for doubtful account of $1,200,000	5,410	
Accounts and notes receivable non-current, net of allowance for doubtful accounts of $531,000 in 1979	623	12,984
Other	1,326	6,432
	7,359	19,416
	$11,575	$34,336

See "Qualification" on Cover Page

Investments in the life insurance company, the 40% common stock interest in Amterre Development Inc (Amterre) and other companies are stated at the Company's equity in net assets; the investment in the preferred stock of Amterre is stated at cost, equal to its liquidating value. In 1979, the investments in Amterre, which is now in liquidation, were reclassified to net assets held for disposition.

9.1 Washington Square Life Insurance Co. (WSL), a wholly-owned subsidiary, provides life, accident and health insurance to the Company's employees and third parties. In addition, WSL administers the Company's basic group life insurance programs. During 1978 WSL advanced the Company $925,000 at 8.5% interest. In settlement thereof, the Company, having obtained the necessary statutory approval, sold two parcels of real estate to WSL at a gain of approximately $600,000 which was not recognized in the Company's consolidated financial statements.

9.2 In May 1978, the Board of Directors of Amterre proposed a plan of complete liquidation and dissolution. On March 21, 1980, the plan was approved by the requisite vote of Amterre's stockholders, including by a majority vote of all stockholders other than Food Fair and the officers and directors of Food Fair and Amterre. Adopted under Section 337 of the Internal Revenue Code, the plan must be effected and all assets distributed to shareholders within twelve months of the date of adoption. Assets and properties not disposed of within the 12-month period will be transferred into a limited partnership whose principal objective will be the disposition of such assets and properties. Holders of Amterre common stock would receive limited partnership units on the basis of one unit of each share of common stock held. A subsidiary of Food Fair will serve as one of the general partners of the limited partnership. The Amterre plan provides among other things for the redemption, at the stated redemption price of $100 per share, of all of the 20,000 shares of Amterre 6% Preferred Stock which are held by the Company.

As a consequence of the Company's Chapter XI Proceedings, store closings and Amterre's anticipated liquidation, a number of claims and disputes arose among Food Fair, Amterre and their respective subsidiaries. Negotiations among the parties resulted in an agreement dated July 5, 1979, which agreement has been approved by the Court. The agreement provides for substantial changes in the terms of many of the Company's leases with Amterre. In addition, Amterre's claims against Food Fair were settled by offsetting its claims as of May 31, 1979, other than for current rents and charges, virtually in full against amounts it owed to the Company, including prepayment of $864,000 of long-term notes relating to six shopping centers. On September 26, 1979, the Company received payment of the net balance of approximately $650,000 plus interest that remained owing to it under the agreement.

The Company's equity in Amterre's operations was a gain of approximately $2,477,000 in 1979 and a loss of $525,000 in 1978, which amounts are included in the caption "Other income, net" and have been adjusted to include dividends paid or due on preferred stock. The Company is obligated to Amterre under 22 leases expiring at various dates through 2001.

10. Borrowings

10.1 Under a revolving accounts receivable purchase agreement the Company has sold accounts receivable to a bank with recourse. Interest is payable monthly at 2% above the bank's prime rate. At both July 28, 1979 and July 29, 1978 outstanding borrowings were $15,000,000. Average and maximum borrowings were both $15,000,000 in 1979, and $14,859,000 and $15,000,000, respectively in 1978.

(Figures in tables in thousands)

The average interest rate was 13.3% in 1979 and 9.9% in 1978. In fiscal 1980, approximately $11,650,000 of these borrowings were paid without prejudice from restricted funds by order of the Court. The remaining balance of $3,350,000 is collateralized by all assets of the Company except inventory, subject to other liens, and is being negotiated by the Company and the bank, so as to settle upon the portion of the debt, which will continue to be treated as secured. Any settlement with respect thereto will require Court approval.

On July 28, 1978, the Company entered into a $28,000,000 revolving credit agreement with a consortium of banks with interest at ½% (2½% upon default) above the banks' prime rates. In August, 1978, the Company borrowed the full amount available, of which $3,400,000 was used to pay demand indebtedness which was outstanding at July 29, 1978. On May 25, 1979, the Company paid without prejudice the $28,000,000 loan balance plus interest but the collateral, which includes certain land and buildings, its investment in and advances to Amterre, and certain notes receivable have not been released.

10.2 At July 28, 1979, substantially all unsecured short and long-term debt had been reclassified to liabilities deferred pursuant to Chapter XI Proceedings (Note 4) or net assets held for disposition (Note 3.3). Interest on such debt ceased to accrue as a result of the Chapter XI filing on October 2, 1978.

	July 28, 1979 — Included in Balance Sheet Caption			July 29, 1978
	Liabilities Deferred Under Chapter XI	Net Assets Held For Disposition	Long-Term Debt	
Notes:				
Banks	$ 55,288	$ 81	$	$ 56,563
Other	6,123	11	467	7,191
Mortgage Loans, Maturing 1979 to 2001 with interest ranging from 4.5% to 10.5%		35,745	18,184	60,647
4% subordinated debentures	10,350			10,375
8.5% subordinated debentures	17,000			17,000
8.38% sinking fund debentures	31,309			31,325
	$120,070	$ 35,837	18,651	183,101
Less current portion of long-term debt			7,743	124,954
			$ 10,908	$ 58,147

At July 28, 1979 and July 29, 1978, the Company was in default of restrictive covenants in certain of the agreements and the lenders had the right to accelerate payment of the outstanding borrowings under these agreements. Accordingly, $6,060,000 at July 28, 1979 and $99,007,000 at July 29, 1978 of long-term debt in default has been included in the current portion. Substantially all of the 1978 amount pertained to debt classified as liabilities deferred pursuant to Chapter XI Proceedings in 1979.

(Figures in tables in thousands)

The aggregate annual maturities of long-term debt for the five years subsequent to July 28, 1979 and thereafter in total are:

1980	$ 7,743
1981	1,632
1982	1,631
1983	1,467
1984	1,412
Thereafter	4,766
	$18,651

11. Leases and other commitments

11.1 Leases: In 1979, as described in Note 7, the Company changed its method of accounting for its leases, which consist primarily of supermarket and equipment leases. Supermarket leases are generally capital leases with terms of up to 25 years with four 5 year renewal options. Equipment leases are for data processing equipment, transportation equipment and store fixtures and equipment.

In 1979, as described in Note 3.1 the Company has discontinued its J. M. Fields operations and has significantly reduced its supermarket operations. Accordingly, the following lease information for dates after July 29, 1978, is being provided only for leases applicable to ongoing operations at July 28, 1979.

Classes of leased property:

	July 28, 1979	July 29, 1978
Supermarkets	$ 77,905	$224,864
Discount department stores		98,047
Equipment	22,265	38,984
	100,170	361,895
Less accumulated depreciation	44,439	153,631
	$ 55,731	$208,264

Future minimum lease payments under capital leases and present value as of July 28, 1979:

1980	$ 11,353
1981	10,900
1982	10,470
1983	9,792
1984	8,875
Thereafter	60,260
Total minimum lease payments	111,650
Less amount representing interest	44,956
Present value of net minimum lease payments	$ 66,694

See "Qualification" on Cover Page

Minimum lease payments do not include contingent rentals which may be paid under certain supermarket leases on the basis of a percentage of sales in excess of stipulated amounts. Contingent rentals amounted to $777,000 for capital leases.

Under the provisions of the Federal Bankruptcy Act, landlords are entitled to claim, as damages, an amount not exceeding a maximum of three years' rental payments for property leases. Claims may be reduced by settlements or litigation. Accordingly, liabilities for property leases disaffirmed since the date filing for arrangement under Chapter XI of the Federal Bankruptcy Act have been established at the lesser of future rental payments for the remaining term of the lease or three years rental payments.

11.2 Employment agreement

On January 4, 1979, the Court approved an employment agreement between the Company and its current President and Chief Executive Officer (CEO), under which the Company has paid the CEO $100,000 upon commencement of employment and will pay $350,000 annually for five years. In addition, the Company is obligated, upon termination of the CEO's employment, for annual retirement benefits of $55,000 for the remainder of his or his present wife's life, should she survive him. The Company has also granted him a nontransferable option to acquire up to 200,000 shares of Company's common stock at $2.00 per share on or before January 2, 1984. In January, 1979, the Company deposited approximately $2,150,000 into trust funds (restricted cash) to secure payment under the above contract (Note 3.4)

12. Redeemable preferred stock

The Company is obligated to set aside $120,000 in cash semi-annually as a sinking fund for the redemption of the preferred stock, unless preferred stock dividends are in arrears. The sinking fund obligation is reduced by $100 for each share of preferred stock actually redeemed or purchased. In 1979, the Company did not declare or pay three of the four required quarterly preferred stock dividends and, accordingly, ceased setting aside funds for the sinking fund. At July 28, 1979 cumuiative preferred stock dividends in arrears amounted to $51,000, equivalent to three quarterly dividend payments. In 1980 as the Company did not declare or pay the preferred stock dividends for the first three quarters of the 1980 fiscal year, the cumulative preferred stock dividend arrearage reached six quarters dividend, and the holders of the preferred stock therefore became entitled to elect two members of the Board of Directors of the Company. To effectuate the proposed Plan of Arrangement, the Company intends to seek the necessary shareholders' approval of certain amendments to its Restated Articles of Incorporation, including significant changes in the rights and preferences of the outstanding preferred stock.

In 1979, the Company redeemed 75 shares of the preferred stock through open market purchases totalling $5,000. The $2,000 excess of the stated redemption value over the cost of preferred stock redeemed was credited to capital in excess of par. In 1978, 1,200 shares of the preferred stock were redeemed at the stated redemption value.

(Figures in tables in thousands)

13. Stock options

The Board of Directors adopted on April 11, 1979, and the Bankruptcy Court approved by order dated May 2, 1979, a non-qualified employee stock option plan (Plan).

Under the Plan non-transferable options may be granted to certain officers and key employees at prices equal to the mean of the closing bid and asked prices on the date of grant. The Plan provides that no option may be exercised prior to six months after the date of grant and that options are cumulatively exercisable thereafter at 25% annually. The options expire ten years from the date of grant.

Changes during 1979 under the Plan were as follows:

	Shares Reserved	Options Granted	Options Available
Balance, July 30, 1978			
Reserved	150		
Granted		105	45
Balance, July 28, 1979	150	105	45

The prices on options granted under the Plan range from $3.50 to $4.44 at July 28, 1979. No Plan options became exercisable in 1979 (Note 11.2 regarding an option for an additional 200,000 shares granted to the Company's current President and Chief Executive Officer).

14. Income taxes

The Company recognized available income tax credits, principally representing the recovery of previously provided deferred taxes, in the year ended July 29, 1978. The income tax credit for the year ended July 29, 1978 consists of the following:

	1978
Current:	
Federal (benefit)	($ 407)
State	1,338
Deferred (benefit)	(9,707)
	($8,776)

A reclassified reconciliation of expected income tax benefit in 1978 computed at the statutory Federal income tax rate of 48% in comparison with actual follows:

	%	1978
Computed expected income tax benefit	(48.0)	($48,480)
Operating loss carryforward	27.3	27,588
Rate differential on deferred income tax reversal	8.2	8,233
Rate differential on refunds due to net operating loss carryback	2.5	2,521
State income taxes, net of federal tax effect	.7	696
Other, net	.7	666
	(8.6)	($ 8,776)

(Figures in tables in thousands)

Deferred tax expense results from timing differences in the recognition of revenue and expense for income tax and financial statement purposes. The sources of these differences in 1978 and the tax effect of each is as follows:

	1978
Excess of tax depreciation over straight-line depreciation	($10,750)
Amount of investment credit for income tax purposes over amount allowable for financial reporting purposes	7,449
Excess of cash payments for self-insurance of workmen's compensation over expense for financial reporting purposes	(2,179)
Changes in accounting methods resulting in income for financial reporting purposes but not for income tax purposes:	
Warehouse overhead	(1,532)
Payroll taxes	(948)
Other timing differences, net	(1,747)
	($ 9,707)

The Company and its domestic subsidiaries file a consolidated Federal income tax return. At July 28, 1979 the Company had available to reduce future taxable income, net operating loss carryforwards approximating $204,000,000, of which $46,000,000 expires in 1985 and $158,000,000 in 1986. For financial reporting purposes, approximately $66,000,000 has been expensed which is not currently deductible for tax purposes but will be available to reduce future taxable income. In addition, the Company has available investment tax credit carryforwards which have not been quantified as of July 28, 1979.

The Federal income tax returns of the Company have been examined by the Internal Revenue Service through 1978. The Internal Revenue Service initially proposed adjustments which would have resulted in additional taxes of approximately $9,600,000 at July 29, 1978. During 1979, many of the proposed adjustments have been settled in favor of the Company. However, at this time management is unable to determine the ultimate outcome of the examination.

15. Pension plans

The Company and its subsidiaries have various noncontributory pension plans covering certain hourly and salaried employees. Pension expense for 1979 and 1978 was $4,699,000 and $1,585,000, respectively. Pension plan costs are funded as accrued except that a waiver has been obtained whereby certain 1978 costs will be funded over a 15 year period.

According to the 1979 valuations, the actuarially computed value of vested benefits for certain of the plans exceeded funds assets and balance sheet accruals by approximately $4,950,000. The total unfunded prior service cost of all the plans is estimated to be $12,509,000. See Item 1, Employee Relations, for discussion of contingencies.

16. Financial statement reclassifications

Certain reclassifications have been made in the 1978 consolidated financial statements to conform to the classifications used in 1979.

See "Qualification" on Cover Page

17. Selected interim financial data (unaudited)

Unaudited selected interim information for the 28 weeks ended February 10, 1979, the 12 weeks ended May 5, 1979, and the 12 weeks ended July 28, 1979 is not presented as the deficiencies in the accounting systems and recordkeeping (Note 2) do not allow management to assess the effect that numerous year end adjustments have on previously issued interim financial data. In addition, selected interim financial information for the 16 weeks ended November 18, 1978 of fiscal year ended July 28, 1979 is not presented for the reasons mentioned above and the filing on October 2, 1978, of petitions for an arrangement under Chapter XI of the Bankruptcy Act (Note 4) which adversely affected the Company's ability to report financial information.

Quarterly financial information for the year ended July 29, 1978 is not presented since it is management's opinion that certain adjustments made at the end of fiscal 1978 pertained to earlier periods of that year and as a result the previously reported unaudited quarterly financial information was inaccurate. It has been determined that any attempt to restate previously reported quarterly results would be impracticable, if not impossible.

18. Supplementary information on effects of changing prices (unaudited)

In accordance with the requirements of Financial Accounting Standards Board Statement No. 33, "Financial Reporting and Changing Prices", certain financial information which was prepared on the basis of historical cost has been adjusted to reflect the impact of inflation. Two different methods are prescribed by Statement 33 for measuring the estimated effects of changing prices. Both require the use of approximations and estimates and are intended to provide approximate rather than precise indicators of the effects of inflation. It is important to recognize that the methods and interpretations thereof are in their development stage and will require refinement over time. In addition, the accounting and internal control conditions described in Note 2 have affected the approximations and estimates used.

The first method, "Constant Dollars", requires the adjustment of historical costs for the impact of general inflation by using the Consumer Price Index for all Urban Consumers (CPI-U) as a measurement of the general inflation rate. The objective of this method is to provide financial statement information in dollars of equivalent purchasing power (constant dollars). Application of this method requires converting opening and closing inventory amounts, and property and equipment of the Company's ongoing operations into average 1979 dollars with the resulting adjustments to ongoing cost of goods sold and depreciation and amortization expense. This is accomplished by applying to the original asset cost the change in the CPI-U for the elapsed period from acquisition to 1979. These adjustments result in increases in depreciation and amortization of $30,500,000 and in costs of goods sold of $8,300,000. In the opinion of management, the increase in cost of goods sold resulting from the restatement of inventory under the constant dollar method does not properly reflect the effects of inflation as this method presumes the retention of inventory over extended periods of time. In reality, the time span between the purchase and sale of inventory in substantially all of the Company's operations is sufficiently short to provide for the reflection of the effects of inflation in historical financial information.

Net sales and expenses other than those related to asset adjustments are not required to be adjusted as they are stated substantially in average 1979 dollars in the historical financial statements.

The second method, "Current Cost", adjusts historical costs for the impact of changes in specific prices. The objective of this method is to reflect the current cost of the assets utilized in the Company's ongoing operations, rather than their historical costs.

The information adjusted for the change in specific prices was prepared by converting historical carrying costs of property and equipment to the cost of replacing these assets at July 28, 1979 with a corresponding adjustment to related depreciation and amortization expense. These adjustments were generally based on external price indexes. As indicated above, inflation's effect on inventory is reflected in the historical statements and accordingly the adjustment to inventories and cost of goods sold, exclusive of depreciation and amortization was minimal. The adjustment to depreciation and amortization for specific price changes was $37,500,000.

The gain from decline in purchasing power results from holding net monetary liabilities during periods of inflation. Net monetary liabilities are amounts owed, reduced by cash and claims to cash, all of which are fixed in terms of dollar value. Redeemable preferred stock is considered a monetary liability.

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended July 28, 1979 and July 29, 1978

(Figures in tables in thousands)

STATEMENT OF LOSS FROM ONGOING SUPERMARKET OPERATIONS AND SELECTED SUPPLEMENTARY FINANCIAL DATA ADJUSTED FOR CHANGING PRICES

Year Ended July 28, 1979

	Ongoing Operations	Adjusted For General Inflation	Adjusted For Changes in Current Costs
Net Revenues	$1,024,904	$1,024,904	$1,024,904
Costs and expenses:			
Cost of sales	819,644	833,867	826,710
Provision for creditor claims	13,058	13,058	13,058
Operating and administrative expenses	207,559	239,123	245,399
Interest expense, net	11,776	11,776	11,776
	1,052,037	1,097,824	1,096,943
Loss from ongoing operations before unusual items	($ 27,133)	($ 72,920)	($ 72,039)
Deficiency in assets at year end	$ 162,765	$ 70,145	$ 42,325
Gain from decline in purchasing power of net monetary liabilities		$ 63,517	$ 63,517
Increase in value of inventories and property and equipment held during the year based on:*			
General price level			$ 32,401
Specific prices (current cost)			25,832
Excess of increase in general price level over increase in specific prices			$ 6,569

*At July 28, 1979 current cost of inventories was $86,594 and current cost of property and equipment, net of accumulated depreciation was $225,630.

FIVE YEAR COMPARISON OF SELECTED SUPPLEMENTARY FINANCIAL DATA

ADJUSTED FOR EFFECTS OF CHANGING PRICES

	1979	1978	1977	1976	1975
Revenues					
Supermarket locations	$1,492,243	$3,072,512	$2,852,573	$3,116,023	$3,280,548
Cash dividends per common share		$ .22	$ .23	$ .25	$ .26
Market price per common share at year end		$ 4⅞	$ 6⅜	$ 6½	$ 6⅛
Average consumer price index	207.1	188.8	176.8	166.9	156.4

See "Qualification" on Cover Page

SCHEDULES FURNISHED

PURSUANT TO THE REQUIREMENTS

OF REGULATION S-X

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

SCHEDULE II—AMOUNTS RECEIVABLE FROM UNDERWRITERS, PROMOTERS, DIRECTORS, OFFICERS, EMPLOYEES AND PRINCIPAL HOLDERS (OTHER THAN AFFILIATES) OF EQUITY SECURITIES OF THE PERSON AND ITS AFFILIATES

Column A	Column B	Column C	Column D			Column E	
			Deductions			Balance at close of period	
Name of debtor	Balance at beginning of period	Additions	(1) Amounts collected	(2) Amounts written off	(3) Other	(1) Current	(2) Not current
Year ended July 28, 1979:							
Jack Millman	$ 27,000				$27,000(b)		
Herbert Zandler	22,500					$ 22,500	
Roy Reiner	40,000		$20,000		20,000(a)		
Elmer DiFillipo	15,000				15,000(a)		
Henry Kirschner	17,800				17,800(a)		
	$122,300		$20,000		$79,800	$ 22,500	
Year ended July 29, 1978:							
Elmer DiFillipo		$25,000	$10,000			$ 15,000	
Herbert Zandler	$ 22,500					22,500	
Edward Shulkin	13,025		13,025				
George Pope	25,000		25,000				
Jack Millman	27,000					27,000	
Henry Kirschner	27,400		9,600			17,800	
Roy Reiner	40,000					40,000	
	$154,925	$25,000	$57,625			$122,300	

Note: Each of the above individuals is an employee of the Company.

(a) Applied against guaranteed bonuses payable

(b) Compensation for decline in value of home of relocated employee

See "Qualification" on Cover Page

FOOD FAIR, INC.
(DEBTOR IN POSSESSION)

SCHEDULE V—PROPERTY AND EQUIPMENT

(In Thousands)

Column A	Column B	Column C	Column D	Column E	Column F	Column G
Classification	Balance at beginning of period	Additions at cost	Retirements	Reclassification to net assets held for disposition	Other changes— add (deduct)— describe	Balance at end of period
Year ended July 28, 1979:						
Land	$ 27,499	$ 1,768	$ 674	$ 21,270	$	$ 7,323
Buildings	90,660	3,454	655	65,802	(4)(a)	27,653
Leasehold improvements	57,572	1,055	1,895	38,914	4 (a)	17,822
Fixtures and equipment	118,482	3,865	3,957	69,087	42 (a)	49,345
Automobiles and trucks	10,602	195	174	270	(42)(a)	10,311
Leased assets capitalized	361,895	1,644		263,369		100,170
	$666,710	$11,981	$ 7,355	$458,712(c)	$ —	$212,624
Year ended July 29, 1978:						
Land	$ 27,749	$ 773	$ 1,052		$ 29 (a)	$ 27,499
Buildings	93,912	321	4,611		(42) 1,080 (a)	90,660
Leasehold improvements	57,017	6,908	2,994		(2,341) (1,018)(a)	57,572
Fixtures and equipment	131,724	4,674	12,333		(5,492) (91)(a)	118,482
Automobiles and trucks	11,721	752	1,852		(19)	10,602
Leased assets capitalized(b)	343,461	18,434				361,895
	$665,584	$31,862	$22,842		($ 7,894)	$666,710

(a) Reclassifications.

(b) Restated, see Note 7 to notes to consolidated financial statements.

(c) As of July 28, 1979 approximately $142,288,000 had been disposed of.

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

SCHEDULE VI—ACCUMULATED DEPRECIATION AND AMORTIZATION OF PROPERTY AND EQUIPMENT

(In Thousands)

Column A	Column B	Column C	Column D	Column E	Column F	Column G
Description	Balance at beginning of period	Additions charged to costs and expenses	Retirements	Reclassification to net assets held for disposition	Other changes—add (deduct)—describe	Balance at end of period
Year ended July 28, 1979:						
Buildings	$ 41,747	$ 2,380	$ 553	$ 31,102	($ 3)(a)	$ 12,469
Leasehold improvements	26,662	2,974	789	19,720	(1)(a)	9,126
Fixtures and equipment	72,943	8,333	3,956	48,184	34 (a)	29,170
Automobiles and trucks	8,329	881	27	328	(30)(a)	8,825
Leased assets capitalized	153,631	12,485		121,677		44,439
	$303,312	$27,053	$ 5,325	$221,011(c)	$ —	$104,029
Year ended July 29, 1978:						
Buildings	$ 41,535	$ 3,054	$ 2,818		$ 18 (a) (42)	$ 41,747
Leasehold improvements	25,955	4,151	1,079		(2,341) (24)(a)	26,662
Fixtures and equipment	74,493	11,926	7,990		(5,492) 6 (a)	72,943
Automobiles and trucks	8,111	1,142	905		(19)	8,329
Leased assets capitalized(b)	136,602	17,029				153,631
	$286,696	$37,302	$12,792		($7,894)	$303,312

(a) Reclassifications.

(b) Restated, see Note 7 to notes to consolidated financial statements.

(c) As of July 28, 1979 approximately $81,691,000 had been eliminated due to dispositions.

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

SCHEDULE XII—VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

(In Thousands)

Column A	Column B	Column C		Column D	Column E
		Additions			
Description	Balance at beginning of period	Charged to costs and expenses	Reclassification to net assets held for disposition	Deductions—describe	Balance at end of period
Year ended July 28, 1979:					
Allowance for doubtful accounts:					
Current	$2,062	$13,355	($11,443)	$ 717(b)	$ 3,257
Deposits		1,200			1,200
Accounts and notes receivable, non-current		531			531
Closed			11,443		11,443
Allowance for loss on the disposal of assets of terminated operations		46,955		4,068(c)	42,887
	$2,062	$62,041(a)	$ —	$ 4,785	$59,318
Year ended July 29, 1978:					
Allowance for doubtful accounts	$1,057	$ 1,690(a)		$ 685(b)	$ 2,062

	1979	1978
(a) Increase in reserve (above)	$62,041	$ 1,690
Charged directly to bad debt expense	969	2,543
Total expense	$63,010	$ 4,233

(b) Write-off of uncollectible accounts

(c) Charges to reserve for leases disaffirmed subsequent to July 28, 1979

See "Qualification" on Cover Page

FOOD FAIR, INC.

(DEBTOR IN POSSESSION)

SCHEDULE XVI—SUPPLEMENTARY INCOME STATEMENT INFORMATION

(In Thousands)

Column A	Column B Charged to Costs and Expenses	
Item	1979	1978
Maintenance and repairs	*	*
Depreciation and amortization of intangible assets, preoperating costs and similar deferrals	$27,053	$37,302
Taxes, other than income taxes		
Payroll	$22,211	$20,661
Property and general	13,508	8,976
	$35,719	$29,637
Rents	$17,069	$14,756
Royalties	*	*
Advertising costs	$34,389	$40,557

*Less than 1% of total sales and revenues

See "Qualification" on Cover Page

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STOCK PRICE DATA

The table sets forth the high and low sales price of the Company's common stock on the New York Stock Exchange for each quarter of fiscal 1978 and the portion of the first quarter of fiscal 1979 through October 31, 1978 when the stock was traded on the New York and other stock exchanges. After October 31, 1978, the Company's common stock has been traded in the Over-the-Counter Market. The table shows the high-asked and low-bid price quotations reported by the National Quotation Bureau for the portion of the first quarter from November 1, 1978 through November 18, 1978, and the remaining quarters of the 1979 fiscal year, as well as the first three quarters of fiscal 1980. The Company's common stock was delisted from the New York Stock Exchange effective October 17, 1978, and suspended from trading on the Philadelphia and Pacific Coast Exchanges effective November 1, 1978.

Fiscal Year	Fiscal quarter ended	High	Low	Dividends
1978	November 19, 1977	7⅜	5	5 cents
	February 11, 1978	5½	4¾	5 cents
	May 6, 1978	5¾	4⅝	5 cents
	July 29, 1978	5⅞	4⅝	—
1979	November 18, 1978			—
	July 30-Oct. 31	5⅛	2⅜	
	Nov. 1-Nov. 18	2½	1	
	February 10, 1979	3¼	1⅝	—
	May 5, 1979	4½	1¾	—
	July 28, 1979	4	2⅞	—
1980	November 17, 1979	3⅞	3	—
	February 9, 1980	4¾	2¾	—
	May 3, 1980	4¾	1⅜	—

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